S-t-r-e-t-c-h-i-n-g for Shareholders

PepsiCo, Inc.
1988

At PepsiCo we're stretching. Stretching to develop high-quality products for our consumers . . . to create a challenging and rewarding workplace for our employees . . . to provide a secure future for their families . . . and to build a great company that makes a positive contribution to society.

All this is made possible by stretching to achieve our primary objective. And that's to build genuine value for our shareholders, the owners of our company.

We stretched far in 1988. It was the best year in PepsiCo's history. And it set the stage for an even better future.

Our report this year looks at three key ways we build shareholder value: by increasing sales, improving margins and wisely investing our capital.

Our performance was exceptional. Our prospects are exciting.

So . . . s-t-r-e-t-c-h out and read on!

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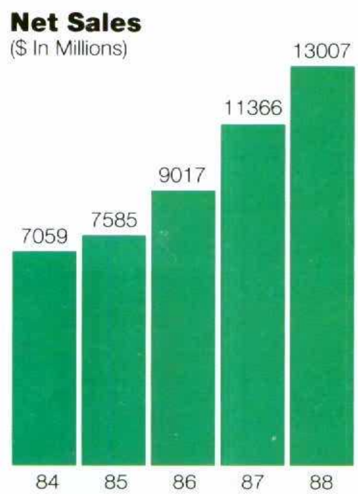
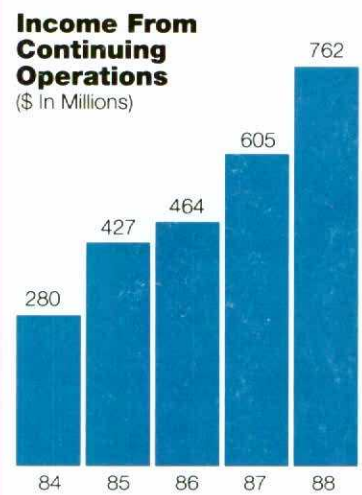
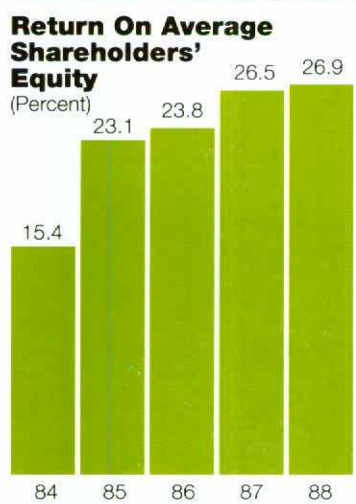
Financial Summary

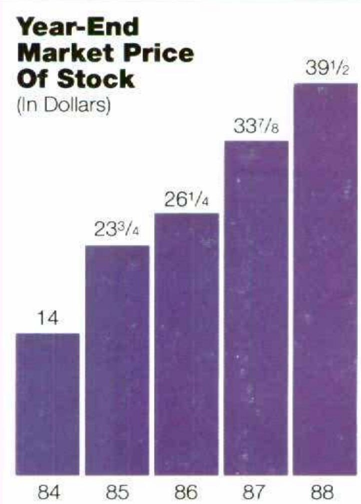
($ in millions except per share amounts)		1988	1987	Percent Change
Net sales	$	13,007	11,366	+14
Income from continuing operations	$	762	605	+26
Per Share	$	2.90	2.30	+26
Net income	$	762	595	+28
Per Share	$	2.90	2.26	+28
Cash dividends declared	$	209	175	+19
Per Share	$	0.80	0.67	+19
Property, plant and equipment additions	$	730	775	− 6
Net cash generated by continuing operations	$	1,895	1,335	+42
Shareholders' equity per share	$	12.03	9.63	+25
Return on average shareholders' equity	%	26.9	26.5	

Return on average shareholders' equity was calculated using income from continuing operations.









PepsiCo's markets are big, global and growing: soft drinks, snack foods and restaurants. We've achieved a leadership position in each.

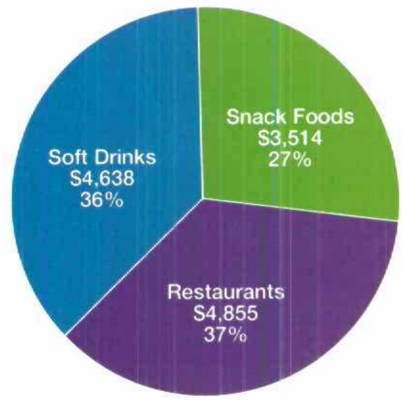
Our businesses are among the best known and most successful in the world: Pepsi-Cola, Frito-Lay, Kentucky Fried Chicken, Pizza Hut and Taco Bell.

Our products are among the best-selling, most-respected and fastest-growing brand names, with systemwide retail sales that total more than $40 billion worldwide.

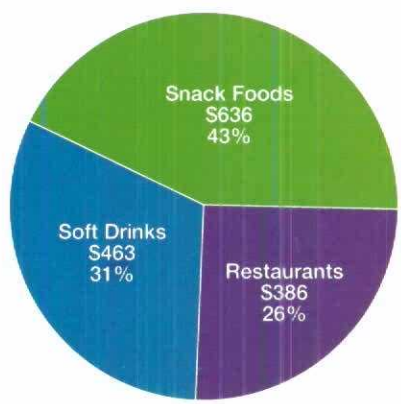
Our overriding corporate objective is to maximize the value of our shareholders' investment, primarily through rapid sales growth, close control of costs and astute application of our financial resources.

Our 235,000 employees are dedicated to making PepsiCo the premier consumer products company in the world.

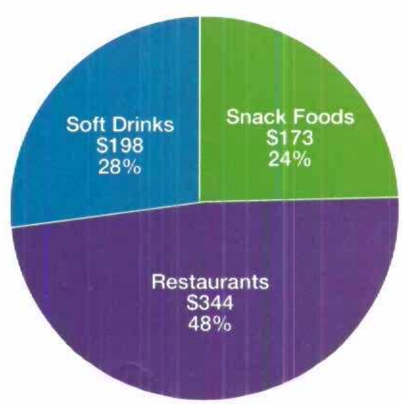
Segment Net Sales
Total: $13,007
($ In Millions)



Segment Operating Profits
Total: $1,485
($ In Millions)



Segment Capital Spending
Total: $715
($ In Millions)



To Our Shareholders and Employees:

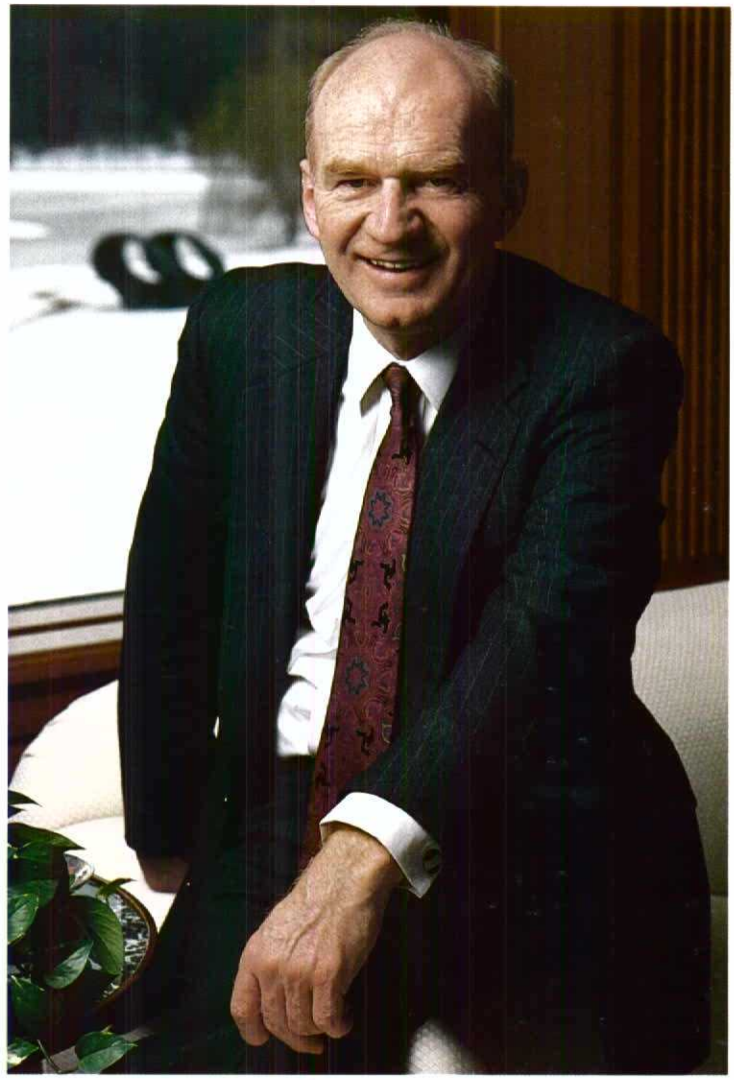
I'm very pleased to report that each of our three business segments achieved record sales and operating profits in 1988. These gains reflected important volume increases both domestically and internationally, larger shares of growing markets, and continuing improvements in profit margins and productivity.

Our operating performance was strong and well-balanced, and raised our overall corporate results to new standards of excellence:

- Net income increased 28% to $762 million.
- Income from continuing operations was up 26% to $2.90 per share.
- Sales were up 14% to $13 billion.
- Net operating cash flow rose $560 million or 42% to nearly $1.9 billion.
- Return on average shareholders' equity reached an all-time high of 26.9%.

Our gains in each of these key financial measurements were on top of a record performance the prior year. In fact, by Labor Day we actually had earned as much from ongoing operations as we did in *all* of 1987.

We believe these impressive performance gains are reflected in the continuing increase in the price of PepsiCo stock–up 18% in 1988 and 52% in the past two years. This gain compares very favorably to an increase of 19% since 1986 in the Standard and Poor's industrial stock index.



D. Wayne Calloway
Chairman of the Board and Chief Executive Officer

A Strategic Focus on Shareholder Value

These performance gains also reflect our continuing commitment to create genuine and long-lasting value for you, our shareholders. We want to provide you consistently superior returns on your investment through a combination of dividends and stock price appreciation.

The key to this is the impressive net cash flow generated by our continuing operations, which has more than doubled in just three years.

We've achieved dramatic gains in shareholder value in recent years, and these gains reflect the success of the strategic restructuring of our operations that we initiated in 1984. We focused our resources on three consumer businesses–soft drinks, snack foods and restaurants–because they share several key strategic characteristics.

These characteristics also are the most important factors that affect shareholder value in our businesses, and they are *within* our control. These factors are our ability to: (1) increase the sales of our products, (2) improve our profit margins and (3) wisely invest the cash our businesses generate to build the value of PepsiCo *even further*.

We call these strategic factors "value drivers," and even relatively minor improvements in these value drivers can produce major gains in operating profits and, in turn, in shareholder value.

Value from Increased Sales

Our first strategy for creating shareholder value is to increase sales–specifically, to increase our sales faster than the industry to solidify our leadership position.

Although our markets are large, there's still tremendous growth potential. Importantly, we can stimulate that growth through our own actions. In 1988 we increased sales in each of our segments by double-digit rates. Soft

drink sales were up 17%, snack foods up 10% and restaurants up 16%–from record levels in 1987.

We build sales by revitalizing established brands through the introduction of great-tasting new varieties. We did this in 1986 with Cool Ranch Doritos tortilla chips, for example. The result: In 1988 this single flavor variety produced retail sales of $270 million and boosted sales of the entire Doritos line to more than $1 billion.

We also build sales through entirely new products, such as Hand-Tossed Traditional Pizza. Introduced at mid-year, it already accounts for 20% of Pizza Hut's total pizza sales.

And we build sales by offering consumers even more value for their money. The new value-oriented menu introduced late last year by Taco Bell continues to generate double-digit sales growth. And this growth is reversing the slight decline in operating profits that Taco Bell experienced in 1988.

Value from Higher Profit Margins

Our second strategy for creating shareholder value focuses on margin improvement, and is based upon our well-honed operating and executional skills.

Our manufacturing, distribution and sales systems are very large and very complex. And they are very responsive to actions we take to raise profit margins by reducing costs and improving efficiency. In 1988 we increased our operating profits $222 million, and more than 25% of this increase was due solely to margin improvements.

Frito-Lay raised its operating profit margin to an all-time high in 1988. We're confident we can increase it even further, thanks in large measure to continuing productivity improvements. Most of these improvements have been suggested by our employees–men and women who take real ownership of their jobs and genuine pride in their achievements.

As a result, Frito-Lay has been able to keep manufacturing costs per pound virtually flat over the last seven years. There's good reason for this focus on productivity. Every penny we save in per pound manufacturing costs generates more than $10 million in additional snack food operating profits.

Productivity pays in soft drinks and restaurants as well. A one-cent saving on each case of soft drinks yields $4 million in operating profits. And reducing the labor of just one person in each of our restaurants by only one hour a day produces an $8 million gain in operating profits.

We'll continue our efforts to improve margins.

Value from Careful Investments in Our Future

Our third strategy for increasing shareholder value reflects our ability to very profitably invest in our own businesses.

Our operations not only generate strong cash flows, but also provide ample opportunities to invest that cash in businesses we know, where we can earn a return well above our 11% cost of capital. We can invest in existing operations to increase sales and improve efficiency. Or we can acquire new operations closely related to our own.

For example, our investment in delivery at Pizza Hut has proven to be a very profitable way to expand our presence in the growing pizza market. In 1988 delivery accounted for 25% of Pizza Hut's total sales growth. And each dollar invested in a delivery unit generates more than three times as many sales dollars as a comparable investment in a traditional unit.

We've also demonstrated the ability to quickly assimilate new operations and achieve significant profit growth. Consider our purchase in late 1986 of Kentucky Fried Chicken. Since that time KFC's operating profits have nearly doubled, and prospects for continued growth have never been brighter.

The soft drink bottling business also provides an excellent opportunity to build for the future.

The Minneapolis Pepsi-Cola franchise we acquired as part of the 1986 acquisition of MEI Corporation is a good example of our ability to increase both efficiency and profits. In the first full year, we achieved purchasing and production savings that totaled 35 cents per case. At the same time we increased volume 12% and bottling plant profits 65%, and raised our market share by three points.

Last year we invested nearly $1.6 billion in acquiring other Pepsi-Cola bottling operations, most of them contiguous to territories we already owned. These acquisitions diluted our earnings per share by eight cents in 1988, but they provide significant opportunities for very profitable growth in the years ahead as we continue to increase sales and reduce costs.

Similarly, we're confident that the pending purchase of General Cinema Corporation's bottling operations will prove to be a low-risk and high-profit way to create significant shareholder value over the long term.

Great Results...From Great People

Our exceptional performance over the last several years has generated a great deal of very favorable comment by

the financial analysts who follow our businesses and the news media who report on our industries.

I'm particularly pleased by our ranking in Fortune magazine's survey of "America's Most Admired Corporations." This year we not only repeated as the top company in our industry, we also were rated seventh most admired overall – seventh among more than 300 corporations.

It's no coincidence that one of the attributes in which we ranked first in our industry was our ability to attract, develop and retain talented men and women. That's the ultimate source of our success. People really do make a difference at PepsiCo.

Our ability to attract top people certainly extends to our Board of Directors. Robert S. Strauss has served our company for six years, providing thoughtful business counsel as well as keen insight into public policy issues. Bob retires in May at age 70. We welcome Roger B. Smith of General Motors to our Board. The unique vantage point he has as chairman and CEO of the world's largest industrial corporation brings a valued perspective to our company.

The Best Is Yet to Come

We've achieved record sales and earnings in both 1988 and 1987. In fact, in these two years alone, our net income has surged 67%.

We still have tremendous potential for further gains. Consider this: In the last five years, our net income has more than doubled. Since PepsiCo was founded in 1965, we've roughly doubled our business *every* five years.

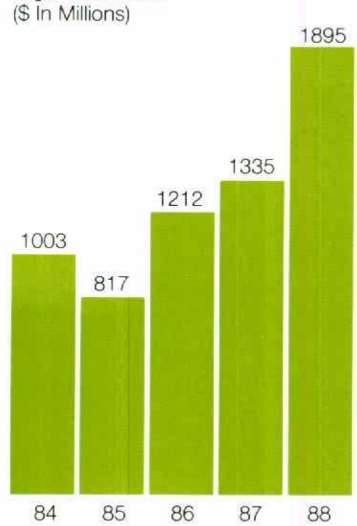
Everyone in the PepsiCo family relishes these achievements and looks forward to even greater achievements in the years ahead. We have no crystal ball. But we do have great products, dedicated people, tremendous momentum and unshakeable confidence in our ability to achieve even higher returns for our shareholders in the future.

The best is yet to come.

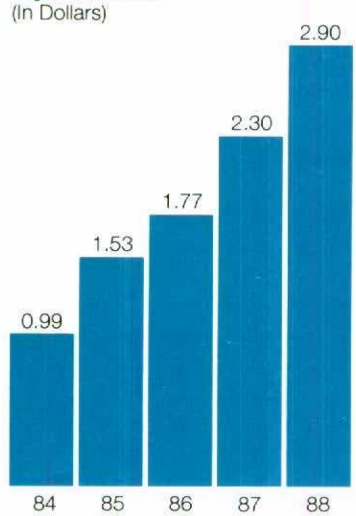
Wayne Calloway

D. Wayne Calloway
Chairman of the Board and
Chief Executive Officer
February 23, 1989

Net Cash Generated By Continuing Operations
($ In Millions)



Income Per Share From Continuing Operations
(In Dollars)



Stretching for Shareholders

We stretch to increase the value of our shareholders' investment by concentrating on three major "value drivers."

This year our Operating Review explains how we put these value drivers to work for our shareholders:

Value Driver: Increasing Sales

Sales growth comes from creating and marketing popular products. Ours are some of the biggest, best-known and most aggressively marketed brand names in the world.

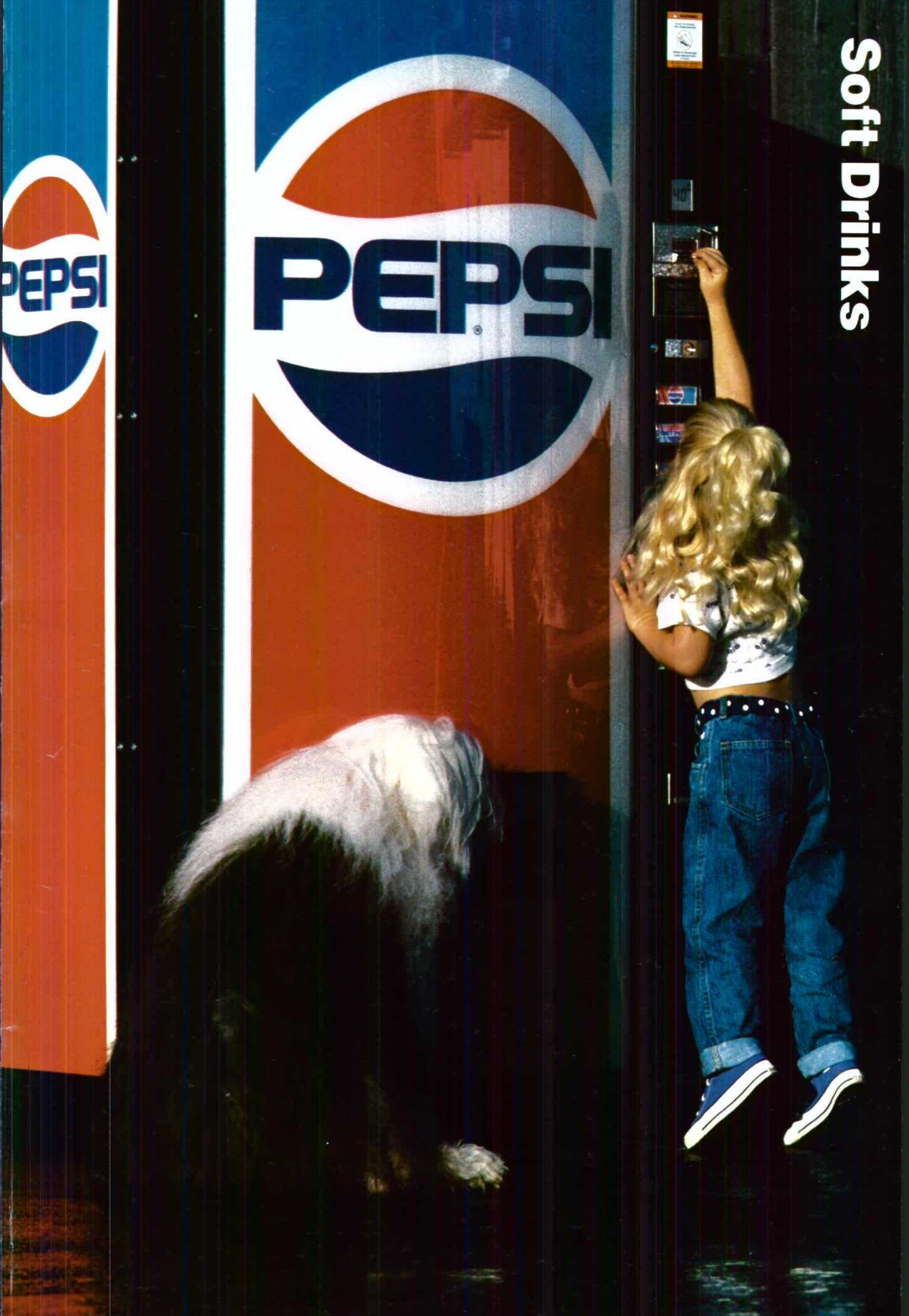
Value Driver: Improving Margins

Profit margin is the difference between the selling price of a product and the cost to produce and sell it. We use our manufacturing and marketing skills and huge operating systems to make more money on each product we sell by consistently finding new ways to reduce costs and maximize efficiency... without reducing quality or service.

Value Driver: Investing Capital

We expect the cash we invest in our businesses to earn a return well in excess of 11%, which is our cost of capital. We're fortunate because all three of our businesses offer ample opportunities to do this. We can achieve consistently superior returns with relatively little risk by investing in businesses we know... in existing operations or in closely related acquisitions.

Soft Drinks



Pepsi-Cola Company
Pepsi-Cola International

Sales	**$4.638 billion**
Growth over 1987	**+17%**
Operating Profits	**$463 million**
Growth over 1987	**+13%**
U.S. Market at Retail	**$42 billion**
Pepsi-Cola Share The Pepsi-Cola system accounts for one-third of the U.S. soft drink market.	**$14 billion**
U.S. Industry Growth	**+4.6%**
Pepsi-Cola System Growth Volume growth outpaces the industry for six consecutive years.	**+6.7%**

Operating Highlights

- U.S. retail sales of brand Pepsi-Cola–one of the world's most famous products–climb to more than $8 billion. It outsells every other brand, of every other product, in supermarkets.
- We invest about $1.6 billion to acquire bottling operations that will permit us to become the lowest cost producer and highest impact marketer in even more areas.
- In a massive strategic reorganization, Pepsi-Cola Company decentralizes to put greater focus on local market initiatives.
- Diet Pepsi achieves fifth year of double-digit volume growth.
- Mountain Dew brands achieve extraordinary growth.
- New agreement provides for significant expansion of Pepsi-Cola soft drink market in the U.S.S.R.
- Brand Pepsi is the leading cola in Canada.
- A new bottling plant opens in China; plans for more will expand Pepsi-Cola's position in this huge market.
- A landmark joint venture agreement with India will bring Pepsi-Cola products to this country of 800 million people.

Soft drinks set records the entire year. Net sales increased 17%, operating profits rose 13% and capital spending totaled $198 million.

Industry Perspective

The U.S. soft drink industry is everything you would want in a great business–it's large, profitable and growing rapidly.

The industry reached a record $42 billion in retail sales in 1988. Consumption totals nearly 46 gallons of soft drinks for every man, woman and child–and it's growing at more than 4% each year, with no signs of stopping.

International soft drink industry volume, at approximately 12 billion cases–about one and one-half times the volume of the U.S. industry–also is increasing. Consumption is only about five gallons per person but steadily increasing, meaning there's still enormous potential for overseas growth.

Competition is intense, but that's what makes the business dynamic and a great investment, with strong long-term growth opportunities. Even *more* important, as a market leader we can create even more growth through our own actions. This is significant because even small percentage gains in volume can mean big profit increases.

In the United States and throughout the world, Pepsi-Cola products command a major share of the soft drink market. For example, brand Pepsi is the leading soft drink in U.S. supermarkets, the largest distribution channel. In fact, brand Pepsi is the best-selling product of *all* brands of *any* kind in super-

markets. Internationally, we market our products in nearly 150 countries, and we're the leading international beverage company in more than 40 markets.

Pepsi-Cola products are one-third of the U.S. soft drink market, and our volume grew at 6.7% this year–some 45% faster than the industry. In fact, this is the sixth consecutive year that Pepsi-Cola brands have grown faster than the industry.

Pepsi-Cola International, which markets Pepsi-Cola and 7UP brands outside the United States, accounts for about one-seventh of the total international market–and grew at a rate of 4%.

When it comes to our three key value drivers, here's how we're stretching for shareholders.

Increasing Sales

During 1988 four key strategies produced record sales:

1. We reorganized our entire U.S. operations to focus even more attention on local markets.
2. We continued our much publicized and highly successful "Big Event Marketing" program.
3. We sharpened our focus on diet soft drinks.
4. We further strengthened our international markets.

Here's a more complete look at these strategies.

1. We reorganized our U.S. operations for greater impact in the local market.

Even though sales have reached new highs for four consecutive years, in early 1988 we reorganized our domestic soft drink operations. The reason: to put even more pressure on local markets. We're convinced the cola wars of the 1990s will be fought increasingly on a local level, and we wanted to gain a competitive advantage by making the move early.

Pepsi-Cola formerly was organized by distribution channels. The new structure combines all distribution channels–concentrate sales, company-owned bottling operations and fountain syrup sales–into one company. Responsibilities now are divided on a geographic basis among four divisions: Pepsi-Cola East, Pepsi-Cola West, Pepsi-Cola South and Pepsi-Cola Central.

The divisions still are united by national marketing strategies, but each division has great freedom to translate these strategies into local market initiatives.

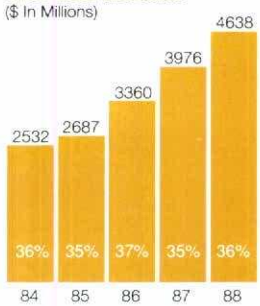
For example, as part of our Big Event national marketing program, Pepsi-Cola sponsored the Tyson-Spinks match for the heavyweight boxing championship. A single national advertising theme was supported regionally by a variety of local promotions and special ticket giveaways. Promotions for the event in Chattanooga were different from those in Chicago because our sales needs are different in the two locations.

Markets are becoming increasingly more segmented and specialized, and we believe regionalization will be the marketing trend of the 1990s.

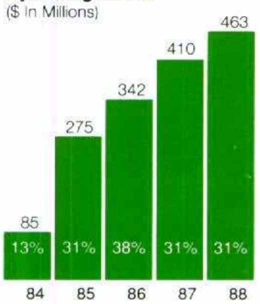
2. We continued our highly successful Big Event Marketing program.

We're committed to what we call Big Event Marketing. Using major events as a centerpiece, we develop exciting advertising and promotions that capture consumer and media attention.

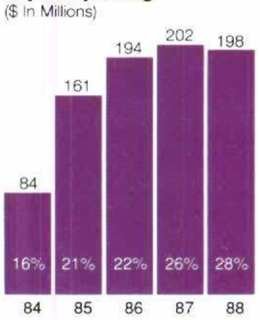
Soft Drinks
Net Sales
% Of Total Net Sales
($ In Millions)



Soft Drinks
Operating Profits
% Of Total Segments Operating Profits
($ In Millions)



Soft Drinks
Capital Spending
% Of Total Segments Capital Spending
($ In Millions)



One of the best examples of how this works is the release of the home video "E.T.," one of the most popular films of all-time. The program included a joint E.T./Pepsi commercial and an offer for a rebate on the video with proof of purchase of Pepsi-Cola products.

Our tie-in with E.T. gained us unprecedented levels of attention and coverage. In fact, coverage of major news events such as rock concerts, the America's Cup Race, the Tyson-Spinks fight and the release of the E.T. video generated more than $12 million worth of added media exposure.

Big Event Marketing captures attention and generates significant media coverage.

3. We focused on diet soft drinks.

Diet beverages are the fastest-growing soft drink category – growing at a compounded annual rate of 11% since 1983. As the population ages and becomes more calorie conscious, diet soft drinks are expected to continue their rapid growth.

We began to sharpen our focus on diet soft drinks about five years ago. Our strategy was to expand the market for our diet products, improve their taste and promote them with big events.

With Diet Pepsi we began by looking beyond the traditional female market and developing advertising and promotions that also appealed to men. Then in 1988 we introduced an improved taste. We promoted the new taste by featuring Michael J. Fox, one of the country's most popular television and movie stars, in our advertising. We also sponsored two of the major sporting events of the year: the Tyson-Spinks boxing championship and the America's Cup sailing challenge.

In both cases, we picked the winner of the contest *before* the event. This was a bold move, and it created unprecedented levels of consumer and media interest and excitement. The results were spectacular: Diet Pepsi volumes grew about 50% faster than the overall diet segment.

Now we're going after another diet market segment. In 1987 we introduced Diet Mountain Dew, a diet soft drink for our longtime Mountain Dew consumers, that focused new attention on the Mountain Dew brand. As a result, Mountain Dew has become the seventh largest soft drink in the industry.

4. We strengthened international markets.

In international markets we're strengthening our position in three ways:

- Focusing on high-potential markets.
- Capturing attention with exciting advertising and Big Event Marketing.
- Joining with strong business partners.

High-potential markets: We've identified several high-potential markets for further development. One key market is Canada, where Pepsi-Cola and 7UP now account for more than one-third of all soft drink supermarket sales and brand Pepsi is the leading cola in supermarkets. That success is the result of a sharper spending focus, as well as consolidation of the bottling network.

Another key market is the Soviet Union, where we've signed an agreement that will increase the number of plants and more than double the Pepsi-Cola

The Power of Our Products:

Pepsi-Cola products are among the best-known brands in the world. Here are the estimated 1988 retail sales of our largest brands.

PEPSI

$13 BILLION

ONE CALORIE DIET PEPSI

$2.5 BILLION

Mountain Dew

$1.7 BILLION

7UP

$1 BILLION

Does not include U.S. sales

business there over the next decade.

Advertising and Big Event Marketing offer special opportunities in international markets. For example, in 1988 we aired the first paid television advertising in the history of the Soviet Union. The commercials were hailed as a landmark and received worldwide attention as a news story.

Strong business partnerships: With aggressive partners, we're positioning ourselves for further growth. For example, in Thailand our two-year-old joint venture is achieving excellent success. Profits have nearly doubled since the partnership was established. In the United Kingdom volume increased by 30%, the result of our two-year-old joint venture with Britvic Corona, Ltd.

Improving Margins

The intensely competitive nature of the soft drink industry makes it important to be the low cost producer in the marketplace. Even small improvements can produce dramatic results. In the United States alone, a one-cent per case reduction in operating costs increases our pre-tax profits by $4 million annually.

There are three major strategies for improving margins in our soft drink business:

1. Reducing the cost of materials.
2. Lowering operating expenses.
3. Reducing our need for cash.

Here's how we stretch in each.

1. Reducing material costs.

We're developing new ways to improve our margins by reducing the costs of raw materials. This year, for example, we're reviewing a program to make plastic two-liter bottles on the production line, which would reduce transportation, storage and handling costs. If used across our entire system, this program has the potential to save us more than $10 million a year.

2. Lowering operating costs.

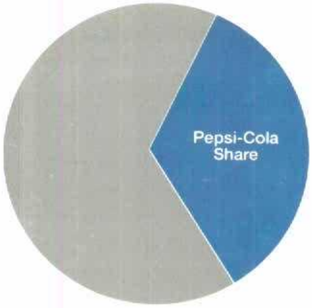
The acquisitions we've made in recent years make it possible for us to lower our operating costs. By acquiring new territories contiguous to ones we own, we're able to reconfigure our systems. For example, in Minneapolis we consolidated sales routes and warehouses and achieved efficiencies of scale in purchasing. These and other measures led to savings of some 35 cents per case.

3. Reducing cash needs.

We're reducing our need for cash by finding new ways to do more with the same number of dollars. For example, we've worked out delivery schedules that allow us to keep our 18-wheeler trucks going around the clock. By utilizing these expensive transport vehicles better, we've reduced the need to purchase additional vehicles. In the last two years alone, we've reduced our capital needs for these trucks by $10 million.

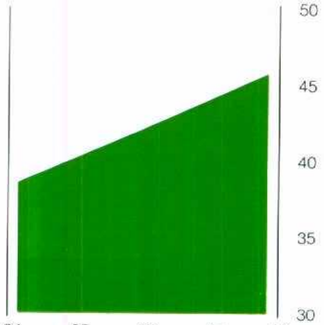
Plant and manufacturing equipment is an important area for reducing cash needs. In Indianapolis we helped our franchisee design a new plant that cost several million dollars less to build than traditional soft drink bottling plants. Its productivity on a per case basis is better than the old plant's. As a result, the Indianapolis bottler is now

U.S. Soft Drink Industry Retail Sales Pepsi-Cola Share



U.S. retail sales of soft drinks total a new high of $42 billion. With sales totaling $14 billion, Pepsi-Cola brands account for one-third of this rapidly growing market.

U.S. Soft Drink Consumption
(Gallons Per Capita)



U.S. soft drink consumption continues to climb by more than 4% each year, and in 1988 reached a record of nearly 46 gallons for every man, woman and child.

even more competitive. The story of how it was done is on this page.

Improving Margins: Creating a Bottling Plant the New Way

For 41 years the Pepsi-Cola Bottling Company of Indianapolis, an independent bottler, operated out of the same downtown facility–a sprawl of six different buildings. While business needs were being met, operations were complex and expensive. As the plant's management team looked to the future, it decided the time was right for a new facility with a more strategic approach to building design, equipment layout, material storage and people involvement. The snag: the huge amount of capital needed for a project this massive.

Undaunted, the Indianapolis team, with the help of the Pepsi-Cola Company Engineering Department, decided to try a new approach to plant design. The traditional approach in the industry is to start with plans for a food processing plant–then eliminate those features not specifically needed for soft drink bottling. Instead, the Pepsi-Cola team started with a warehouse–and then added only those features needed for beverages. Equipment was taken from the existing facility, refurbished and reinstalled in the new plant. Employees at all levels were involved in order to ensure that the people responsible for operations had a major part in the design.

The result is a less expensive, more efficient plant–one where people participate in the decision-making process. The new layout includes additional shipping docks so raw materials are delivered on a just-in-time basis, eliminating extra handling and storage. Only minimal levels of inventory are kept on hand, and finished product is shipped on trucks that also serve as mini-warehouses, reducing the need for storage space. The improvements that have been made in productivity, safety, quality and service ensure that the facility will serve the area's growing needs for many years to come.

The Indianapolis plant is an excellent example of an innovative approach to plant design and to the power of teamwork. The bottler is now able to make Pepsi-Cola products even more competitively.

And the results justify the cost: Even including the cost of starting up the new plant, the Indianapolis team's manufacturing costs are running at 3% less per case than at the old facility.

Lower manufacturing costs mean the Pepsi-Cola bottler in Indianapolis can be even more competitive.

Investing Capital

The third way we stretch value for shareholders is by investing in projects that will accelerate growth and give us returns that exceed our cost of capital. In 1988 we invested capital to:

1. Acquire new operations.
2. Expand our markets.

Here's how we stretch.

1. Acquiring new operations.

We invested nearly $1.6 billion to purchase domestic bottling operations in 1988. We acquired these operations because they offer us significant manufacturing and distribution efficiencies by consolidating systems, as well as the opportunity to expand the impact of our marketing activities.

During 1988 we purchased the bottling operations of Grand Metropolitan Incorporated, the third largest independent bottler of Pepsi-Cola products, and 11 smaller bottling operations. Company-owned operations now account for approximately 37% of Pepsi-Cola U.S. volume. We also purchased a 20% interest in Pepsi-Cola General Bottlers, and in early 1989 we announced plans to acquire the bottling operations of General Cinema Corporation, our second largest independent bottler.

2. Expanding markets.

We're expanding our global presence. For example, in China, which has a population of more than one billion, our joint venture opened an additional bottling plant. Two concentrate plants are

scheduled to open shortly. Our first plant was built in 1982, one of the first Chinese-American joint ventures in that country.

Our newest market is India, a country of 800 million people with a fast-growing consumer base. The government has approved our landmark joint venture with the State of Punjab and Tata, India's largest industrial conglomerate, to establish soft drink operations.

Under the agreement, Pepsi-Cola and PepsiCo Foods International, our international snack foods division, will be part of a pioneering venture to establish state-of-the-art food processing plants, a major export program for processed foods and a center for agro-research. The program will draw upon our expertise in these areas and is expected to help generate long-term economic growth in this huge market.

Management's Analysis

(Note: The following discussion should be read in conjunction with "Business Segments" on page 34.)

1988 vs. 1987

Worldwide net sales advanced 17%, reflecting worldwide volume increases and the impact of domestic acquisitions.

Domestic net sales growth reflected the acquisitions of several franchised bottlers, increased concentrate and fountain syrup shipments and volume gains in company-owned bottling operations that were partially offset by greater price discounting. Domestic bottlers' case sales (including company-owned and franchised bottlers) increased 7%, led by significant growth in Diet Pepsi and Mountain Dew and by solid gains in brand Pepsi, partially offset by declines in brand Slice.

International net sales growth reflected strong increases in concentrate shipments to key markets, aided by the favorable translation impact of the weaker U.S. dollar. International bottlers' case sales (including company-owned and franchised bottlers) increased 4%, led by growth in Mexico, Europe, the Pacific and Canada, partially offset by declines in Argentina.

Worldwide operating profits increased 13%. Operating profits grew 22% excluding a $9 million loss resulting from the sale of a winery in Spain and a $15 million charge related to the reorganization of domestic operations in 1988 and a $10 million gain resulting from the sale of a company-owned bottling operation in Puerto Rico in 1987.

Strong domestic operating profit growth reflected higher volume, favorable product sales mix and the impact of bottler acquisitions, partially offset by increased price discounting in bottling operations.

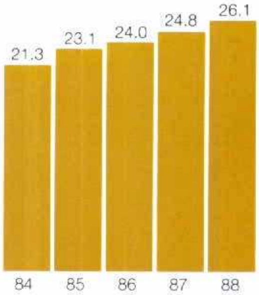
International operating profits increased significantly due to operating margin and volume improvements and the favorable translation impact of the weaker U.S. dollar.

The growth in net sales and operating profits also reflected PepsiCo's 53-week reporting period in 1988, compared to 52 weeks in 1987. Bottler case sales growth presented above is on a calendar year basis.

1987 vs. 1986

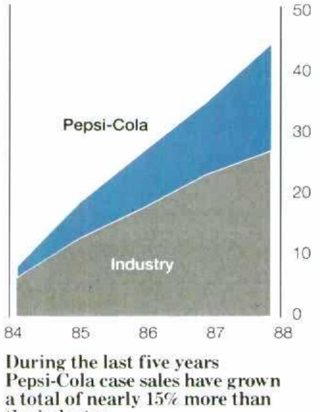
Worldwide net sales increased 18%, while operating profits improved 20% over 1986. This growth reflected the positive

Diet Soft Drinks Share Of Total Market
(Percent)



The diet segment now accounts for more than one-quarter of the total soft drink market. It's the fastest-growing soft drink category, growing by a compounded annual rate of 11% over the last five years. Diet Pepsi volume grew almost twice as fast as the industry during that same period.

Pepsi-Cola System vs. U.S. Industry Case Sales Growth
(% Change Indexed at 1983)



During the last five years Pepsi-Cola case sales have grown a total of nearly 15% more than the industry.

impact of acquisitions, including MEI Corporation (MEI) and Seven-Up International, and strong sales and operating profit gains in both domestic and international operations.

MEI and Seven-Up International, which have been integrated into the Pepsi-Cola domestic bottling and international operations, respectively, were acquired mid-year 1986. Accordingly, the following discussion focuses on comparisons excluding the estimated impact of these acquisitions on the first half of 1987.

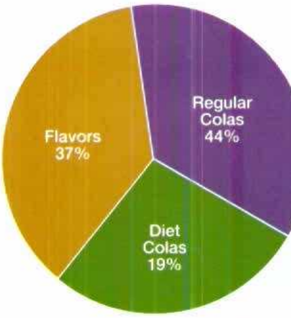
Worldwide net sales improved 11% over 1986. Growth in domestic sales reflected continued volume gains in company-owned bottling operations, which benefited significantly from other smaller acquisitions, as well as growth in concentrate and fountain syrup shipments. Domestic bottlers' case sales (including company-owned and franchised bottlers) increased by 6% in 1987, reflecting solid gains in brand Pepsi, Diet Pepsi and Mountain Dew.

International net sales growth was exceptional primarily as a result of increased concentrate shipments, particularly to Venezuela, Northern Europe and Canada, and the favorable translation impact of the weaker U.S. dollar. International bottlers' case sales (including company-owned and franchised bottlers) increased 7% in 1987, led by Brazil, the Philippines and Canada.

Worldwide operating profits advanced 11% in 1987. Operating profits increased 15% excluding the $10 million gain from the sale of a company-owned bottling operation in Puerto Rico in 1987 and a $19 million gain in 1986 due to collection of a receivable written off in 1978. This performance reflected strong domestic operating profit growth resulting from acquisitions of smaller bottlers, concentrate volume increases, particularly in Pepsi brands, and reduced pension expense resulting from the required adoption of new pension accounting rules. (See Note to Consolidated Financial Statements on page 47.)

International operating profits rose significantly in 1987, primarily reflecting strong volume growth and improved operating margins, partially offset by increased promotional spending.

U.S. Soft Drink Industry Product Segments



Pepsi-Cola's growing portfolio of brands includes strong products in every market segment. Brand Pepsi is our largest-selling brand, and Diet Pepsi is growing at double-digit rates. Our flavors include Mountain Dew (the seventh largest soft drink), new Lemon Lime Slice and Mandarin Orange Slice (the largest-selling orange soft drink).

U.S. Soft Drink Industry Distribution Channels

Pepsi-Cola is expanding its presence in every soft drink distribution channel. We have the leading brand in supermarkets. We've achieved a double-digit compounded growth rate in the fountain segment over the last five years, and we're rapidly increasing the number of vending machines.

Largest Brand In Top-Selling Categories In Major Supermarkets
(Sales In $ Millions)

Brand Pepsi is the leading soft drink in supermarkets, the largest soft drink distribution channel. Brand Pepsi far outsells the leading brands of all other products, in all other supermarket categories.

Stretching for Shareholders

Frito-Lay
PepsiCo Foods International

Sales	$3.514 billion
Growth over 1987	+10%
Operating Profits	$636 million
Growth over 1987	+16%
U.S. Market at Retail	$32 billion
Frito-Lay Share Frito-Lay is the leader in the snack chips segment of the U.S. market.	$4.1 billion
U.S. Grocery Products Growth	+5.0%
Frito-Lay Growth Frito-Lay continues strong sales growth.	+5.4%*

Operating Highlights

- U.S. sales of our major brands grow at 5.7%, sparked by the success of several new flavor varieties.
- New low-oil snacks are introduced to appeal to an entirely new market segment of snackers. Doritos brand tortilla chips leads the way, with other varieties to follow.
- Sales growth accelerated by regional products and promotions.
- Productivity improvements save more than $50 million. Manufacturing costs on a per pound basis kept flat.
- International snack food operations generate strong volume growth of 15%, some three times faster than industry growth.
- A major new partnership with Hostess Foods in Canada offers significantly broader distribution opportunities in the world's fourth largest snack food market.
- We're successfully growing our 1987 acquisitions of Tasty Foods – the market leader in Greece, of Laprovar in Portugal and our joint venture with Tong Yang in Korea.

*Sales benefited from an additional week's results.

Snack foods operating profits were up 16% on a 10% sales increase. Capital spending totaled $173 million.

Industry Perspective

The large and fast-growing U.S. snack chips market has retail sales of more than $7.5 billion and an annual per capita consumption of about 12.6 pounds. This consumption rate of products – such as potato, corn and tortilla chips, cheese puffs and pretzels – is high, but still less than four ounces per person each week. There's plenty of room for further growth.

In the United States, Frito-Lay accounts for about half of all snack chips sales and about one-eighth of all snack food sales. While estimated dollar sales of the average U.S. grocery product have grown at a five-year compounded annual rate of 4.5%, Frito-Lay sales have grown at a compounded rate of 5.8% – nearly 30% faster. In fact, Frito-Lay's six major brands – Doritos brand tortilla chips, Fritos brand corn chips, Ruffles and Lay's brands potato chips, Tostitos brand tortilla chips and Chee•tos brand cheese flavored snacks – are among the top 10 snack items sold throughout the United States. Each of these brands sells well over $100 million at retail.

In international markets snack chips retail sales are about $9 billion. Consumption is only a small percentage of the U.S. rate – less than one pound per person annually – but it's growing by about 4% a year. That strongly suggests big per capita growth opportunities as new consumers are introduced to our products.

As the world's largest domestic and multinational snack chips producer, we have the technology, marketing skill and financial resources to take advantage of this worldwide industry growth. The PepsiCo Foods International (PFI) system has snack food operations in 18 countries and accounts for about 28% of total sales in our markets.

When it comes to our three key value drivers, here's how we're stretching for shareholders.

Increasing Sales

During 1988 three specific strategies generated significant sales increases in our snack food business:

1. We introduced new products targeted at separate market segments: frequent snackers and light snackers.
2. We used our operating systems to grow sales through improved distribution.
3. We continued to expand internationally by introducing proven products and operating systems into new markets.

Here's a look at each of these strategies.

1. We segmented the market with new products targeted at frequent snackers and light snackers.

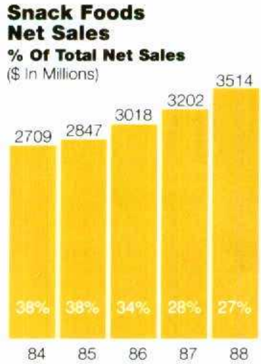
Frequent snackers: The one-third of consumers who are the heaviest snackers buy about three-fourths of all snack chips. We target these frequent snackers through line extensions – delicious new varieties of our major brands. A prime example is Cool Ranch flavored Doritos brand tortilla chips, a delicious taste alternative to traditional Doritos brand tortilla chips introduced in 1986. This single flavor now generates retail sales of $270 million a year – up nearly 30% in just one year.

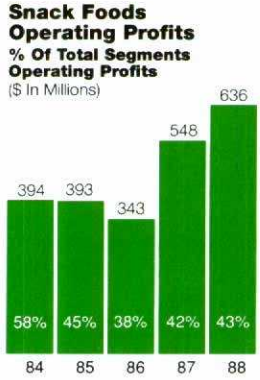
Major 1988 product entries include Italian Cheese flavored Lay's brand potato chips and Salsa Rio flavored Doritos brand tortilla chips. Both are generating excellent sales. We're now introducing Fritos brand corn chips with Wild n' Mild ranch seasoning, and there are several other new products under development.

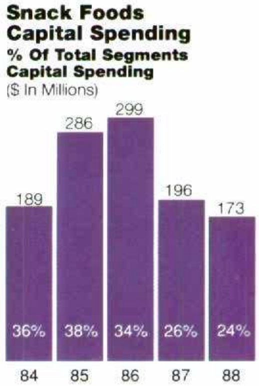
Our line extensions succeed because they combine a new taste with a trusted name. And they generate significant incremental profits for Frito-Lay because they're less costly to produce and introduce.

Medium to light snackers represent the remaining two-thirds of consumers and they account for about one-quarter of snack chips purchases. For these consumers, who may be limiting their consumption, we've taken several initiatives to address their concerns. We've provided nutritional labels, produced no-salt added potato chips, eliminated tropical oils from our snack chips and included a statement assuring them our products have no cholesterol.

A major 1989 initiative is the introduction of Nacho Cheese and Cool Ranch flavored Doritos Light brand tortilla chips, low-oil versions of our top-selling Doritos brand. They have one-third less oil than regular chips. Low-oil versions of Chee•tos brand cheese flavored snacks and Ruffles brand potato chips also are being tested.







The Power of Our Products:

Frito-Lay products are among the best-known in the world. Here are the estimated 1988 worldwide retail sales of our top brands.

Doritos

$1 BILLION

Ruffles

$800 MILLION

Lay's

$700 MILLION

Fritos

$500 MILLION

Chee·tos

$400 MILLION

Tostitos

$200 MILLION

2. Our operating systems produced sales growth through improved distribution.

It's well known that Frito-Lay has a large and powerful manufacturing and distribution system– 40 plants, 1,600 distribution centers and a route sales team of 10,000 men and women.

What's not as well known is how Frito-Lay uses this system to build sales. For example, our route sales team both delivers Frito-Lay products to the store and stocks them on the shelves. This means our products are less expensive for supermarkets to handle than most other items. This makes Frito-Lay brands some of the most profitable products for the supermarket and helps secure scarce shelf space. An important consumer benefit of this system is that we can guarantee freshness and quality.

Another benefit is that supermarkets rarely run out of our products. That's because our sales team is there to restock the shelves, sometimes two or three times on a busy weekend. And when we introduce a new product, we can get it on the shelves quickly and create special displays to build customer interest. For example, Frito-Lay's new Chunky Salsa dip is placed on a special rack right next to the products it complements.

3. International expansion is aided by introducing proven products and operating systems into new markets.

Our U.S. experience gives us a significant advantage in international markets. We use our proven products, and manufacturing and distribution systems to expand into new markets and build sales worldwide. Our international system now includes almost 16,000 employees, 8,000 routes and 31 plants. Through it we market about 100 brands and continue to expand our global brands and new items into additional countries.

This year in Korea we introduced Chee•tos brand cheese flavored snacks. Based upon very successful Korean test market results, we'll soon introduce potato chips in the style of Lay's brand. In Mexico, our largest international market, we've achieved success with sweet snacks. For more on how we grew sales in Mexico, see page 20.

Since our success begins with raw materials, we are investing in international agricultural programs to ensure consistently high product quality. For example, in 1988 we began programs in Korea and Taiwan to develop potato supplies that for the first time will let us produce high quality potato chips for the local markets on a year-round basis.

Improving Margins

There are three major strategies we use to improve margins in the snack foods business:

1. We concentrate on those products and markets that are the most profitable for us.
2. We hold down manufacturing costs by improving productivity.
3. We take advantage of growing efficiencies in international markets.

Here's how each of these strategies helps us stretch for our shareholders.

1. We target those products and markets that are the most profitable.

To generate the highest profits from each sale, Frito-Lay does two things:

• Emphasizes the most profitable products.
• Targets pockets of opportunity.

We emphasize our most profitable products by promoting our proprietary brands, such as Doritos brand tortilla chips and Fritos brand corn chips. These products have unparalleled consumer acceptance so our advertising and marketing expenditures generate the most sales dollars.

We target pockets of opportunity on both a product and distribution basis. For example, we've introduced regional products, such as Lay's brand Crunch Tators potato chips in the Southwest. These are crunchier potato chips, and they're offered in several flavors such as Mighty Mesquite and Hoppin' Jalapeño.

In our channels of distribution, we're focusing more on selling our products through vending machines and food service operations since sales there don't need as much service and support as in supermarkets. Our sales in these channels have grown more than 40% in just the last four years.

2. We hold down manufacturing costs by improving productivity.

Every one cent Frito-Lay saves in manufacturing and selling a pound of product generates an additional $13 million in pre-tax profits. With an incentive that huge, we've focused closely on controlling the cost of making and selling our products. While costs have gradually escalated, the amount it costs for Frito-Lay to make a pound of snack food has stayed virtually flat over the past seven years.

The results of Frito-Lay's continuing emphasis on productivity improvements have been dramatic – savings totaling nearly $240 million in the last eight years. The savings in 1988 alone were more than $50 million.

Most of Frito-Lay's productivity improvements have been suggested by employees. One idea that cost nothing and was implemented immediately saves Frito-Lay merchandisers anywhere from 15 minutes to an hour a day. The idea, called the Plan-O-Gram, standardizes how trucks are stocked. It reduces loading time and improves truck utilization.

Other programs involve complex state-of-the-art technology. For example, Frito-Lay is installing optical inspection systems that continuously check product quality and automatically remove any chips that are less than the highest quality.

3. We take advantage of growing efficiencies in international markets.

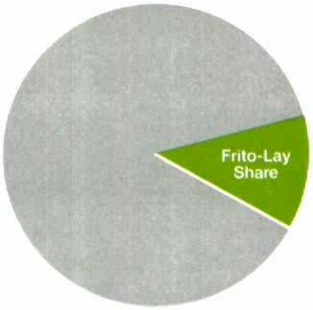
Our international snack food markets offer opportunities for unique economies of scale. For example, we used the basic Ruffles brand potato chip advertising in eight countries, saving $300,000 in ad production costs.

Investing Capital

A third way we stretch value for our shareholders is by efficiently investing capital to improve our systems and expand our operations. In 1988 the major ways we invested capital were:

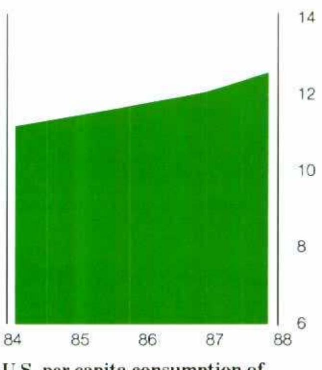
1. Building new plants and improving existing facilities.

U.S. Snack Food Industry Retail Sales Frito-Lay Share



U.S. sales of snack foods total $32 billion. Frito-Lay's share of this market is more than $4 billion, one-eighth of the total market.

U.S. Snack Chips Consumption
(Lbs. Per Capita)



U.S. per capita consumption of snack chips is at an all-time high, some 12.6 pounds per person – and it's continuing to grow at a steady rate.

Driving Sales: Stimulating Growth in Mexico Despite Economic Uncertainty

Mexico is our largest international snack food market. But when Mexico entered the 1980s, it suffered a severe economic crisis. In the midst of hyperinflation and an accompanying recession, the government placed severe restrictions on consumer product promotions and the use of advertising. The question faced by Sabritas, the PepsiCo Foods International company in Mexico, was how to grow sales under those unfavorable economic conditions.

The Sabritas team acted quickly. First Sabritas broadened its product line to include new lower-priced sweet snacks such as hard candy and gum, as well as a variety of smaller snack packages.

Second, Sabritas sought innovative ways to remind consumers of its products and to associate them with quality. Since promotions were restricted, Sabritas created and sponsored programs such as "Play Cleanly," an environmental educational program. The program was so successful in encouraging Mexican citizens to protect their country's environment that the Mexican government encouraged Sabritas to continue its efforts. Additional educational programs focused on "Mexican Heroes" and "Flags of the World."

The government and citizens weren't the only ones pleased with the outcome. In addition to reinforcing Sabritas' role as a responsible corporate citizen, the programs have kept the Sabritas name in the public eye.

Results: Unlike most companies in Mexico, Sabritas' snack chips volume has grown steadily during the economic crisis and reached a new high in 1988.

Educational programs such as "Play Cleanly" ("Juego Limpio") have helped Sabritas generate higher snack food sales in Mexico.

2. Expanding our markets through acquisitions and new partnerships.

1. We invested in new plants and developed innovative ways to add capacity to existing facilities.

Our newest Frito-Lay plant started production in early 1988. Located in Perry, Ga., it's among the world's most technologically advanced snack food manufacturing facilities. The new plant handles a full line of corn and potato snack food products. This means that in peak periods the Perry plant can supplement production of other Frito-Lay plants around the country.

We also improved our existing systems by adding capacity to plants and warehouse facilities, including some very innovative approaches. For example, we've begun to use automated storage and retrieval equipment to stack cartons where people can't normally reach. This increases the amount of finished product that can be stored in our warehouses.

2. We expanded our markets through acquisitions and new partnerships.

We're expanding throughout the world. Here are some recent initiatives:

In Canada, the world's fourth largest snack food market, our partnership with Hostess Foods will increase our distribution as well as reduce costs through system consolidations.

Our newest snack food markets are Italy, India and Turkey. Early entry into such less developed markets gives us the opportunity to gain a strong initial position.

In the United States, we've

purchased Smartfoods, Inc., a very successful marketer of white cheddar cheese-flavored popcorn. This acquisition gives us the opportunity to distribute a new brand.

Management's Analysis

(Note: The following discussion should be read in conjunction with "Business Segments" on page 34.)

1988 vs. 1987

Worldwide net sales rose 10%, reflecting continued volume growth in both domestic and international markets and foreign pricing in line with inflation.

Frito-Lay's total pound shipments advanced 3%, led by increases in Santitas and Doritos brand tortilla chips, Lay's brand potato chips and Chee•tos brand cheese flavored snacks. PepsiCo Foods International's snack chips pound growth was 15%, led by exceptional growth in Mexico and Spain, partially offset by declines in Brazil.

Worldwide operating profits increased 16%. Excluding a $13 million credit in 1987 primarily reflecting a $10 million gain on the sale of a domestic cookie production facility, worldwide operating profits increased 19%. This performance reflected operating margin improvements both domestically and internationally, with double-digit profit growth at Frito-Lay and an even stronger double-digit surge in international profits. Frito-Lay's operating profit improvement resulted from volume increases, manufacturing productivity gains and favorable expense trends. International operating profit growth reflected the significant volume increases, the impact of pricing actions and improved productivity.

Late in the fourth quarter of 1988, PepsiCo acquired a 50% interest in a joint venture for the production and distribution of snack foods in Canada. PepsiCo's investment of $78 million in the unconsolidated joint venture consisted of cash and its previously consolidated Canadian snack foods operations. The consolidated operating results of PepsiCo's Canadian operations were not significant in 1988 or 1987.

The growth in net sales and operating profits also reflected PepsiCo's 53-week reporting period in 1988, compared to 52 weeks in 1987. Pound growth presented above has been adjusted to a comparable period basis.

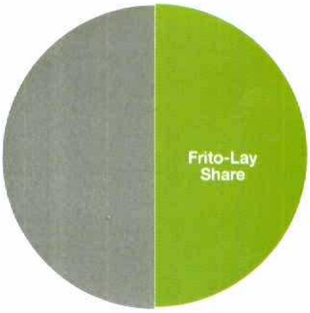
1987 vs. 1986

Worldwide net sales rose 6%, reflecting solid volume gains both domestically and internationally. The adverse translation impact of weakening currencies in Mexico and Brazil on international net sales was offset by pricing actions in these countries.

Frito-Lay's total pound shipments, excluding discontinued products, advanced 5%, led primarily by line extensions of Doritos brand tortilla chips and Ruffles brand potato chips. PepsiCo Foods International's snack chips unit volume advanced 4%, led by strong gains in Brazil, Spain and Puerto Rico.

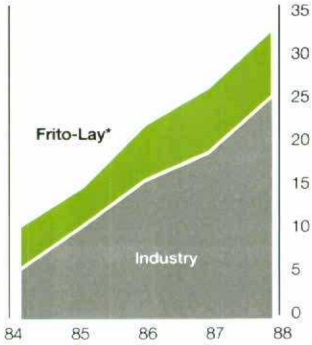
Worldwide operating profits advanced 60%, reflecting exceptionally strong performances both domestically and internationally. The significant increase also reflected a $52 million charge recorded by Frito-Lay in 1986 for

U.S. Snack Chips Industry Retail Sales Frito-Lay Share



Frito-Lay is the world's largest producer of snack chips. In the $7.5 billion U.S. snack chips segment, Frito-Lay accounts for about half of all sales.

Frito-Lay Retail Sales vs. All Grocery Products
(% Increase Indexed At 1983)



*1988 sales benefited from an additional week's results

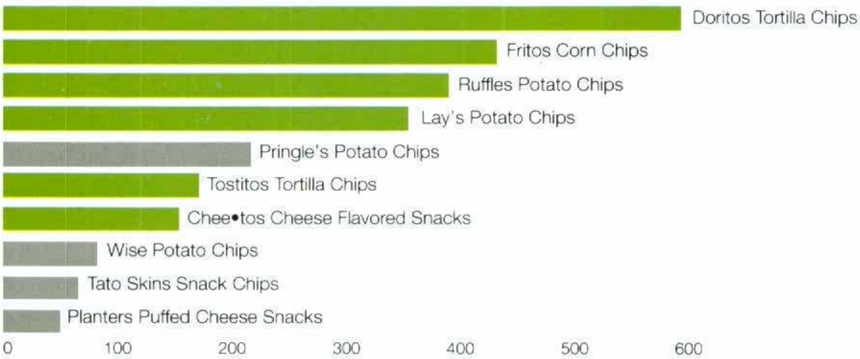
Over the last five years, retail sales of Frito-Lay products have grown some 10% more than retail sales of the average of all grocery products.

the discontinuance of certain non-chip snack products and a reduction of cookie production capacity, and the $13 million favorable adjustment to the 1986 charge recorded in 1987. Excluding these items, worldwide operating profits increased 36%.

Frito-Lay's impressive operating profit improvement also reflected strong growth in core brand snack chips volume and related productivity gains, lower ingredient costs and reduced pension expense resulting from the required adoption of new pension accounting rules. (See Note to Consolidated Financial Statements on page 47.) In addition, 1986 operating profits were depressed by expenses associated with the introduction of new non-chip snack products, which were subsequently discontinued.

Internationally, operating profits rose significantly, reflecting volume growth in Spain, improved operating margins in Canada, Spain and Puerto Rico and small acquisitions.

Top-Selling Snack Chips Brands In Major Supermarkets
(Sales In $ Millions)



Six of Frito-Lay's brands are among the 10 best-selling snack chips brands in U.S. supermarkets. No other company has more than one brand in the top 10.

Stretching for Shareholders

Kentucky Fried Chicken
Pizza Hut, Taco Bell
PepsiCo Food Service International

Sales	**$4.855 billion**
Growth over 1987	**+16%**
Operating Profits	**$386 million**
Growth over 1987	**+10%**
U.S. Market at Retail	**$60 billion**
PepsiCo System Share	**$7.3 billion** Kentucky Fried Chicken, Pizza Hut and Taco Bell systems are the leaders in their quick service restaurant categories.
U.S. Industry Growth	**+8.1%**
PepsiCo System Growth	**+9.0%*** Sales in PepsiCo's restaurant system are among the strongest in the quick service restaurant industry.

Operating Highlights

- PepsiCo's restaurant system, the largest in the world, reaches 17,353 units and continues to grow by about two restaurants a day.
- KFC expands its consumer base with lunchtime products.
- KFC International will open a second restaurant in China and announces plans to build more units in this huge market.
- Pizza Hut reaches a new segment of consumers with its introduction of Hand-Tossed Traditional Pizza.
- Pizza Hut expands delivery and carry-out, the fastest-growing market segments.
- Pizza Hut is expanding international operations to nine new countries.
- Sales at Taco Bell surge with the introduction of a new menu that emphasizes consumer value, featuring a low-priced taco.

* Sales at company-owned restaurants benefited from an additional week's results.

Restaurant revenues climbed 16%, and operating profits were up 10%. Capital spending totaled $344 million.

Industry Perspective

The U.S. quick service restaurant industry reached sales of $60 billion in 1988. It continues to grow at about 8%, with no end to growth in sight. One out of every three meals Americans eat is now prepared away from home.

Internationally, the quick service market is underdeveloped. In major international markets, the segment is growing at a rate almost double that of the U.S. industry. The market is much like that of the United States in the 1960s and 1970s – a period of growing customer acceptance, changing demographics and rapid growth into new geographic regions.

With the world's largest restaurant system – 17,353 units – PepsiCo is in an excellent position to take advantage of this increasing worldwide interest in quick service eating.

In the United States, Kentucky Fried Chicken (KFC), Pizza Hut and Taco Bell restaurants hold leading positions in their segments of the quick service industry. Together they accounted for $7.3 billion in system sales and grew at 9%.

Over the past five years, the PepsiCo system's restaurant sales have grown at a compounded annual rate about 30% higher than the quick service industry. This more rapid growth reflects the fact that our categories – chicken, pizza and Mexican food – are among the largest and fastest-growing segments of

the U.S. quick service restaurant industry.

In international markets we're well-positioned to take advantage of the growth potential. In fact, through KFC International and PepsiCo Food Service International (PFSI) – which handles the international operations of Pizza Hut and Taco Bell – PepsiCo was among the first to enter the international quick service segment. Currently, KFC, Pizza Hut and Taco Bell account for \$2.7 billion in international system sales.

Here's a look at each of our divisions:

KFC is the world's largest quick service chicken restaurant system. In the \$6.2 billion U.S. segment, KFC has system sales of just under \$2.9 billion, about 46% of the market.

Outside the United States, KFC is the only major chicken restaurant chain. Restaurants are located in 57 countries and have system sales of more than \$2.1 billion, bringing KFC's worldwide sales to \$5 billion.

Pizza Hut is the leading pizza restaurant chain in the world. In the United States, the Pizza Hut system has sales of \$2.8 billion, more than 20% of the \$13.5 billion U.S. pizza category. Internationally there are Pizza Hut restaurants in 50 markets, and Pizza Hut is the share leader among pizza chain restaurants in 45. Plans to build Pizza Hut restaurants in several new countries, including two restaurants in the U.S.S.R., are underway.

Taco Bell is the leading chain in the U.S. quick service Mexican category. Its system sales of \$1.6 billion are more than half of the \$2.8 billion category. With 52 Taco Bell restaurants in six international markets, Taco Bell is among the first to develop the Mexican quick service segment worldwide.

When it comes to our three value drivers, here's how we're stretching for shareholders.

Increasing Sales

We relied upon four specific strategies to generate increased sales in 1988:

1. Introducing new products to stimulate consumer interest.
2. Expanding the times of day customers visit our restaurants by offering new menu choices.
3. Increasing the distribution channels for our products.
4. Introducing value-oriented menus to increase volumes.

Here's how these strategies produced record results.

1. Introducing new products to stimulate new consumer interest.

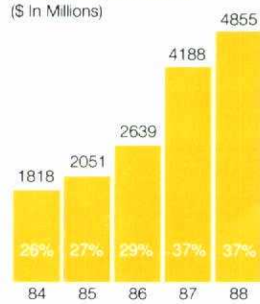
At each of our divisions, we place a heavy emphasis on new products. That's the fastest way to stimulate consumer interest.

Pizza Hut introduced Hand-Tossed Traditional Pizza, a new pizza for consumers who want a medium crust – thinner than Pizza Hut's best-selling Pan Pizza but thicker than Thin 'n Crispy. Hand-Tossed Traditional Pizza was introduced at mid-year and now accounts for about 20% of Pizza Hut's total pizza sales.

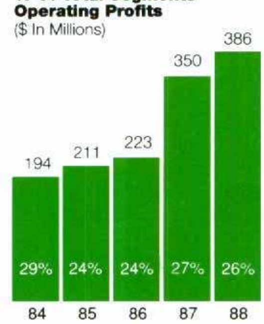
At KFC we're testing menus that include nonfried foods. For example, KFC has a new grilled chicken that's attracting new consumers.

Taco Bell is following last year's successful launch of Steak Fajitas with Chicken Fajitas, and at mid-year Taco Bell also introduced Meximelt, a tortilla with melted

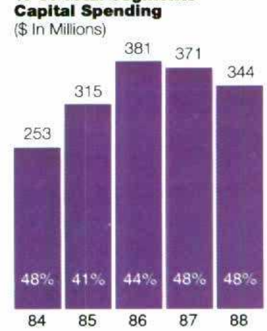
Restaurants Net Sales
% Of Total Net Sales
(\$ In Millions)



Restaurants Operating Profits
% Of Total Segments Operating Profits
(\$ In Millions)



Restaurants Capital Spending
% Of Total Segments Capital Spending
(\$ In Millions)



cheese. Both products increased per store sales during the introductory periods and are expected to continue to attract customers. Chicken Fajitas has the added benefit of attracting new consumers who prefer chicken meals.

2. Offering new menu items that expand the times customers visit our restaurants.

We're successfully stretching the clock by expanding time periods when customers visit our restaurants. In the early 1980s Pizza Hut introduced the five-minute Personal Pan Pizza for lunch, and it proved to be a major success. KFC has adopted the same approach by developing a menu that encourages consumers to come in for lunch and daytime snacks.

It started in 1987 when KFC introduced Chicken Littles sandwiches. Along with shoestring french fries and a soft drink, Chicken Littles sandwiches make an excellent lunch or snack. More consumers are now visiting KFC for meals other than dinner, and many of them are new customers. To continue to grow our non-dinner business, we're developing other products, including a chicken filet burger for customers who want a full-sized sandwich.

3. Increasing the distribution of our products.

Each of our systems is developing new and more convenient ways to offer our products to a broader range of consumers. These include:
- Delivery.
- Special units in shopping malls and other high traffic areas.
- Adapting our concepts internationally.

Here's how broader distribution drives sales.

Delivery is among the most important business building developments in restaurants in the last decade. Within the PepsiCo restaurant systems, Pizza Hut led the way when it tested home delivery of pizza in 1984. After wrestling with the concept for a few years and changing it to better meet consumer demands, delivery has taken off since mid-1987. Our delivery sales are now growing at double-digit rates and are a major part of Pizza Hut's sales growth. To follow up on this success, we're now testing home delivery at KFC.

Shopping malls and other high-traffic areas: KFC, Pizza Hut and Taco Bell are opening units in shopping malls and in food courts. In particularly busy high-traffic areas, such as malls, we've opened Pizza Hut Express units where customers can purchase a Personal Pan Pizza in seconds. In two locations we've placed our three restaurant systems together in one unit. In addition to sharing kitchens and achieving operating efficiencies, the three chains attract more consumers by offering a broader menu choice.

Pizza Hut is also working with Marriott Corp., the largest contract food-service operation, to open portable pizzerias inside hospitals, universities, airports and other locations where contract food service is offered.

Adapting our concepts internationally: In international markets we're adapting the distribution of our products to the local market. For example, pizza by the slice is popular in Europe, self-service is growing sales in Venezuela, units offering only carry-out pizza are popular in the

The Power of Our Products:

PepsiCo restaurant systems sell some of the best-known food products in the world. Here are the estimated 1988 sales of each system's principal product.

Kentucky Fried Chicken

ORIGINAL RECIPE
$2.7 BILLION

Pizza Hut

PAN PIZZA
$1.5 BILLION

TACO BELL

TACO
$500 MILLION

Middle East and we're offering Pizza Hut pizza in British pubs.

4. Introducing value-oriented menus to increase volumes.

A restaurant's success depends upon customers knowing they're getting real value for their food dollars, and each of our restaurants is focusing on increasing consumer value.

Pizza Hut's "Pairs" program offers two pizzas for one low price. This promotion reflects the very successful strategy used in our soft drinks and snack foods businesses of offering larger package sizes. We're encouraging consumers to purchase more pizza per occasion. The "Pairs" program is very attractive to carry-out and delivery customers. And the increased volumes provide economies of scale, resulting in higher profits.

One of the most important growth initiatives by Taco Bell was the introduction of a new value-oriented menu. Taco Bell now offers a low-priced taco that can be eaten either as a main or side dish. This new marketing strategy is designed to reposition Taco Bell as the low-cost, high-value quick service restaurant choice. This strategy was introduced late in the year and has led to double-digit sales growth for four consecutive months.

Improving Margins

In 1988 there were three key strategies for improving margins in our restaurant business:

1. We used our total system to take advantage of savings on purchasing and supply costs.

2. We focused on technology as another way to lower costs.

3. We developed labor management systems that reduce costs while improving service.

These strategies helped produce a 10% increase in operating profits. Here's how.

1. Our total system enabled us to take advantage of cost savings.

We're achieving significant savings on purchasing and supply costs. In 1988 we continued to consolidate the separate operations that supply food and equipment to Pizza Hut and Taco Bell restaurants. In the combined system, trucks no longer stop at a Pizza Hut, pass a Taco Bell and then stop at another Pizza Hut. Instead, the same trucks supply both systems, traveling fewer miles to cover the same number of restaurants. Consolidated operations now cover three-fourths of the system, and consolidation will be completed by 1991.

In our international markets, we're achieving economies of scale as we grow. For example, in Canada where there are now 145 Pizza Hut restaurants, bulk purchasing of meat, cheese and other products from local sources reduced food costs by nearly 3%.

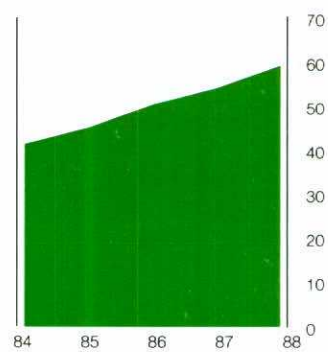
2. Technology helps to lower costs.

Each of our restaurant systems is focusing on technology as another important way to lower costs. For example, at KFC computer-controlled fryers are being installed throughout the system. The new fryers use less cooking oil than traditional units, saving money on both ingredients and labor. In addition, cooking temperatures can be regulated better, so product quality improves and there's much less waste.

U.S. Quick Service Restaurant Industry Retail Sales PepsiCo Share

PepsiCo's U.S. restaurant systems account for sales of \$7.3 billion, about one-eighth of the total quick service industry.

U.S. Quick Service Restaurant Sales
($ In Billions)



U.S. quick service restaurant sales reached a record \$60 billion in 1988 and are continuing to climb as Americans eat more meals prepared away from home.

Investing Capital: Delivery Success Funds the Future

Delivery is the fastest-growing segment of the pizza market, posting a 16% sales gain in 1988 alone. Pizza Hut entered the delivery business in 1984 with the goal of growing sales rapidly. But every dollar invested in delivery had to generate a return higher than it would if invested elsewhere. Delivery had to be the most profitable investment Pizza Hut could make.

Pizza Hut's original concept was based on a central order-taking facility, supported by a network of delivery-only preparation units.

Over the next few years delivery did well in several markets, but financial results weren't meeting Pizza Hut's expectations. So we rethought delivery and made several key changes. For example, we added carry-out to our delivery units and made the units more visible, so consumers could see we were close enough for fast home delivery and convenient for carry-out. In some markets we decided to also offer delivery from our traditional dine-in restaurants. Delivery even changed our menu. We developed our new Hand-Tossed Traditional Pizza to respond to customers who asked for a "regular" pizza.

This new approach paid off. Delivery reached profitability in late 1987, and returns have now reached excellent levels. Today, each dollar invested in a delivery unit generates more than three times as many sales dollars as a dollar invested in a traditional unit. In fact, in 1988 delivery accounted for more than one-quarter of Pizza Hut's total sales growth and half its profit growth at the store level. And adding delivery capability to an existing restaurant generates growth of almost 20% per restaurant.

Result: Pizza Hut Delivery is generating strong sales growth. In fact, if we had never entered the delivery market, we would have had to spend about $200 million in capital to get the same sales growth through our traditional restaurant development.

Delivery now accounts for more than one-quarter of Pizza Hut's total sales growth.

3. Labor management systems reduce costs while improving service.

As in any food service business, scheduling of employees is one of the most critical aspects of our operations. Pizza Hut is testing a computerized labor management system that will reduce labor costs as well as improve customer service.

Managers carefully track staffing needs – each week and each day. The data is entered into the computer and developed into employee work schedules that conform to each individual restaurant's needs. This saves labor costs by making sure that only those employees who are needed are working. In fact, if we reduce the labor of one person by just one hour each day in each of our company-owned restaurants, the annual savings would total $8 million in pre-tax profits.

The new system also improves service since the restaurant is fully staffed at peak times. Employees like the system because, by making sure there are enough staff members to handle busy periods, customers are better served.

Investing Capital

We've continued to invest in our three systems to improve, upgrade and expand operations. In each case our objective is to earn a return on our investment that exceeds our cost of capital. In 1988 three key ways we invested our capital were:

1. Upgrading our systems to improve service and attract more customers.

2. Expanding our pizza delivery operations.

3. Increasing the number of units in our worldwide system.

Here's how we provide increased value for our shareholders.

1. Upgrading systems to improve service and attract more customers.

We continually upgrade and improve our restaurant systems to keep them contemporary, convenient and comfortable places for our customers. Significant changes include more attractive and convenient carry-out areas at Pizza Hut restaurants. This is particularly important because carry-out sales now account for more than one-third of all Pizza Hut pizza sales.

About one-third of KFC sales are from drive-thru customers. To improve service in this growing segment, KFC has redesigned menu boards, improved the communication system between the drive-thru customer and the restaurant staff, upgraded the drive-thru work areas and made other improvements to speed service.

2. Expanding pizza delivery operations.

Delivery provides a great opportunity to profitably expand the Pizza Hut system, and we're growing this channel rapidly. At year-end there were 771 delivery-only units in the United States, supplemented by 1,232 delivery operations based at traditional Pizza Hut restaurants. This capacity is expected to double over the next few years. In fact, in 1988 almost one-fifth of Pizza Hut's capital spending was devoted to expanding delivery. For a closer look at Pizza Hut Delivery, see the story on page 28.

3. Increasing our worldwide system.

We add restaurants both by building new units and by converting units we purchase from other quick service systems. Today, we're able to design and construct new units more cost efficiently than ever before.

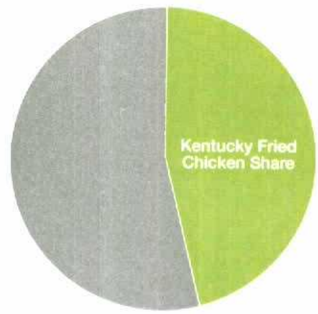
In 1988 we added 883 units to our worldwide system – a rate of more than two per day. The chart on page 30 summarizes our restaurant unit growth. Here are additional highlights.

The KFC system added 239 restaurants in 1988. The company, along with our joint venture partners, built about one-third of the units, with franchisees building the rest. International growth is focusing on high-potential markets such as the Pacific basin area. For example, KFC Japan opened 89 new restaurants, bringing its total to nearly 800 units at year-end. And our flagship KFC in Beijing – the first quick service restaurant in China and also the world's largest KFC – had annual sales of more than $3 million. KFC has opened a second Beijing unit and formed another joint venture to build restaurants in Shanghai, a city of some 12 million people.

Pizza Hut added 313 units in 1988; 116 company-owned, the remainder added by franchisees. Taco Bell added 182 units to its system in 1988.

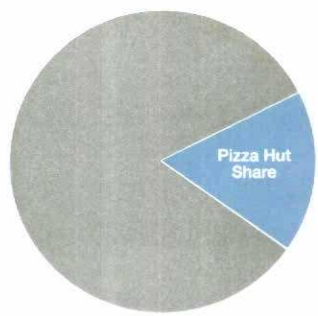
PFSI is expanding international operations to nine new countries. The system added 149 restaurant units, including several units in West Germany that were purchased from another restaurant system and will be converted to Pizza Hut restaurants. PFSI also opened the first

U.S. Chicken Restaurant Market



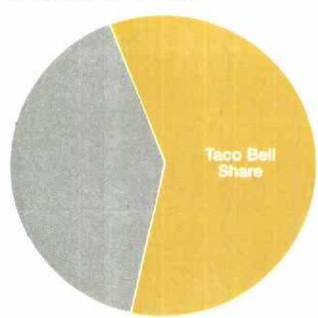
Kentucky Fried Chicken has the leading share of the $6.2 billion quick service chicken restaurant category. KFC's 1988 systemwide sales in the United States totaled $2.9 billion and represented almost half of the market.

U.S. Pizza Restaurant Market



Pizza Hut is the leading pizza restaurant chain in the United States. With systemwide sales of $2.8 billion, Pizza Hut accounted for more than 20% of the $13.5 billion U.S. pizza category.

U.S. Mexican Restaurant Market



Taco Bell is the leader in the U.S. Mexican restaurant category. With systemwide sales of $1.6 billion, Taco Bell accounted for more than half of the $2.8 billion category.

Restaurant Unit Growth

Number of Units Worldwide (Year-end 1983-1988)

Year	KFC	Pizza Hut	Taco Bell	PFSI	Total
1983	5,971	3,996	1,663	334	11,964
1984	6,175	4,208	1,833	404	12,620
1985	6,396	4,482	2,173	518	13,569
1986	6,575	5,017	2,409	663	14,664
1987	7,522	5,394	2,696	858	16,470
1988	7,761	5,707	2,878	1,007	17,353
Five Year Compounded Annual Growth Rate					
	5.4%	7.4%	11.6%	24.7%	7.7%

Totals include KFC, acquired October 1, 1986, as though it were part of PepsiCo since 1983.

Number of Units Worldwide (Year-end 1988)

	KFC	Pizza Hut	Taco Bell	Total
United States				
Company	1,262	2,770	1,691	5,723
Franchise	3,637	2,937	1,187	7,761
International*				
Company	309	214	25	548
Joint Venture	408	217	–	625
Franchise	2,145	524	27	2,696
Total	7,761	6,662	2,930	17,353

* Includes 71 units in Hawaii.

PepsiCo is adding units at the rate of more than two per day.

Restaurant Sales Growth

Average Domestic Unit Sales ($ Thousands)
Combined Company and Franchise

	1983	1984	1985	1986	1987	1988	5 Yr. % Growth
KFC	431	459	502	529	558	597	6.7
PH	412	435	457	468	490	520	4.8
TB	436	539	550	560	579	589	6.2

Domestic and International Sales Systemwide ($ Billions)

	1983	1984	1985	1986	1987	1988	5 Yr. % Growth
KFC	2.6	2.9	3.1	3.5	4.1	5.0	14.0
PH	1.6	1.8	2.0	2.2	2.5	2.8	11.8
TB	.7	.9	1.1	1.3	1.5	1.6	18.0
PFSI	.11	.15	.24	.33	.44	.62	41.3
Total	5.01	5.75	6.44	7.33	8.54	10.02	14.9

Totals include KFC, acquired October 1, 1986, as though it were part of PepsiCo since 1983.

Taco Bell in Japan, one of the largest quick service restaurant markets in the world. Based on our success, we plan to continue this high level of overseas growth for several years, concentrating on markets where quick service restaurants have already proven successful.

Management's Analysis

(Note: The following discussion should be read in conjunction with "Business Segments" on page 34.)

1988 vs. 1987

Worldwide net sales increased 16%, reflecting double-digit growth domestically and internationally. This performance was due to additional restaurants (constructed as well as acquired from franchisees), volume gains, the favorable translation impact of the weaker U.S. dollar and pricing actions.

Domestic net sales growth was led by Pizza Hut, with volume gains and additional stores in both the traditional restaurant and delivery operations. Kentucky Fried Chicken's (KFC) domestic net sales increase was driven primarily by pricing actions and additional restaurants. Taco Bell's net sales increase benefited from additional restaurants and increased volume that occurred in the fourth quarter when a new value-oriented menu was introduced. Combined average sales per domestic company-owned store (including pizza delivery units) rose 6%, reflecting strong increases at Pizza Hut and KFC while Taco Bell was even with 1987.

International net sales improved as a result of the favorable

Taco Bell is building on the success of Steak Fajitas with Chicken Fajitas.

translation impact of the weaker U.S. dollar, an increase in distribution sales at KFC International and additional restaurants.

Worldwide operating profits rose 10%, led by a particularly strong performance internationally. This growth was primarily due to volume increases and additional restaurants, partially offset by higher operating expenses and lower gains resulting from sales of company-owned restaurants (restaurant resales) in 1988.

Pizza Hut's contribution to the domestic operating profit improvement resulted from volume growth in traditional restaurant and delivery operations, partially offset by higher labor and food costs. KFC also posted higher operating profits domestically due to pricing actions, additional stores and franchise fee revenue growth that more than offset increased chicken and operating costs. KFC's improvement also reflected the impact of a 1987 charge related to a reorganization of domestic operations. Operating profits declined at Taco Bell, reflecting higher operating costs and lower gains on restaurant resales, which were partially offset by the impact of additional stores and food cost controls.

Total domestic segment gains on restaurant resales represented 1% and 6% of domestic operating profits in 1988 and 1987, respectively.

International growth was driven by higher franchise fee revenues, the favorable translation impact of the weaker U.S. dollar at KFC International and additional units, partially offset by the impact of a 1987 gain on a resale of several pizza restaurants in Australia.

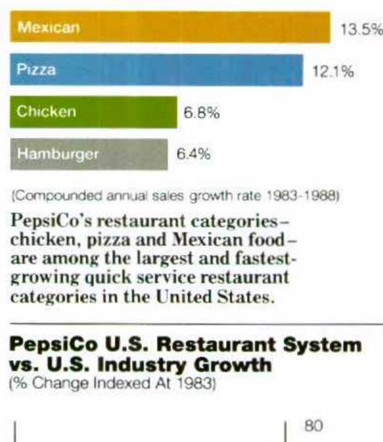
The growth in net sales and operating profits also reflected PepsiCo's 53-week reporting period in 1988, compared to 52 weeks in 1987. The growth in combined average sales per domestic company-owned store presented above has been adjusted to a comparable period basis.

1987 vs. 1986

Worldwide net sales increased 59%, while operating profits improved 57% over 1986. These gains reflected the impact of the acquisition of KFC, as well as reduced losses related to Pizza Hut delivery operations and volume increases at Taco Bell.

For the full year, KFC posted a 6% increase over 1986 in average sales per domestic company-

Fastest-Growing U.S. Restaurant Categories



(Compounded annual sales growth rate 1983-1988)

PepsiCo's restaurant categories – chicken, pizza and Mexican food – are among the largest and fastest-growing quick service restaurant categories in the United States.

PepsiCo U.S. Restaurant System vs. U.S. Industry Growth
(% Change Indexed At 1983)

*1988 sales at company-owned restaurants benefited from an additional week's results.

Over the last five years, PepsiCo's restaurant system sales have grown some 20% more than sales in the quick service industry.

owned restaurant and significant growth in profits fueled by international operating gains. Because KFC was acquired in October 1986, the following discussion focuses on comparisons excluding the impact of KFC's operations in both years.

Worldwide net sales advanced 18% over 1986, due primarily to the addition of new restaurant and pizza delivery units and volume increases. Aggressive promotional programs and significant gains in average sales per delivery unit contributed to Pizza Hut's growth. Taco Bell's sales were also aided by pricing actions and new products, such as the soft shell taco and Steak Fajitas introduced in the first half of the year. Combined average sales per domestic company-owned Pizza Hut and Taco Bell restaurant rose 4% for the year. International sales improved significantly as a result of new store development and the favorable translation impact of the weaker U.S. dollar.

Worldwide operating profits rose 12% due to improved Pizza Hut delivery operations, the gain on a resale of several pizza restaurants in Australia and reduced domestic pension expense resulting from the required adoption of new pension accounting rules. (See Note to Consolidated Financial Statements on page 47.)

Domestically, Pizza Hut's strong operating profit advances reflected significantly reduced delivery losses, partially offset by higher promotional spending and lower gains on restaurant resales. Taco Bell's operating profits increased as a result of higher volumes and gains on restaurant resales, partially offset by higher cost of sales and increased occupancy expenses. The increase in cost of sales, mitigated by pricing actions, reflected the higher cost of ingredients and Steak Fajitas. Gains on restaurant resales at Pizza Hut and Taco Bell represented 8% of domestic operating profits in both 1987 and 1986.

Significantly increased international operating profits reflected the restaurant resale gain in Australia. Excluding this gain, operating profits were down from a small base in 1986, reflecting start-up losses associated with significant growth in new restaurant and pizza delivery units.

Restaurant Units Top 10 Chains
(In Thousands)

The combined units of Kentucky Fried Chicken, Pizza Hut and Taco Bell make PepsiCo the largest restaurant system in the world.

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Business Segments

This information constitutes a Note to the Consolidated Financial Statements.

PepsiCo operates on a worldwide basis within three distinct business segments: soft drinks, snack foods and restaurants. Management's discussion and analysis of PepsiCo's business segments begin on pages 13, 21 and 30 under the caption "Management's Analysis."

The soft drinks segment primarily manufactures concentrates and markets Pepsi-Cola, Mountain Dew, Slice and their allied brands worldwide and 7UP internationally, and conducts soft drink bottling businesses principally in the United States. For purposes of this Note, the operations of the soft drink concentrate manufacturing facilities in Puerto Rico are allocated between domestic and foreign based upon the actual concentrate shipments to the respective markets.

The soft drinks segment data reflects several acquisitions over the last three years, the largest of which were the franchised domestic bottling businesses of Grand Metropolitan Incorporated and MEI Corporation acquired in 1988 and 1986, respectively, and the international franchise business of The Seven-Up Company (Seven-Up International) acquired in 1986.

The snack foods segment primarily manufactures and markets snack chips.

The restaurants segment includes the operations of Pizza Hut, Taco Bell and Kentucky Fried Chicken (KFC), which was acquired in 1986.

The acquisitions were accounted for under the purchase method, and accordingly the soft drinks and restaurants segment data include the acquired operations from their respective dates of acquisition. (See Note to Consolidated Financial Statements on page 43.) The acquisitions of KFC and Seven-Up International had a significant impact on PepsiCo's foreign operations, as reflected in the foreign data presented.

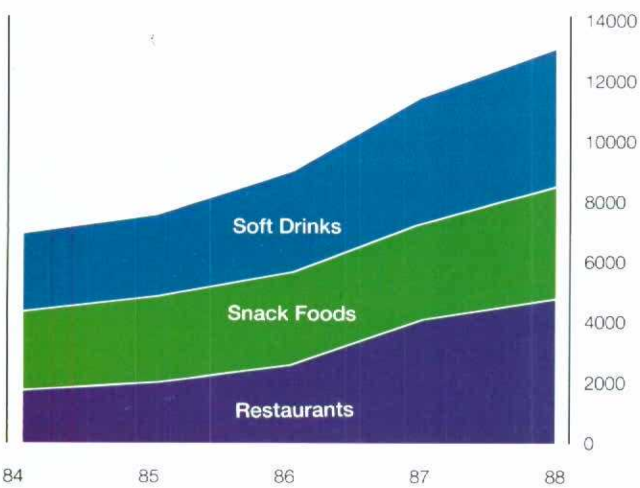
PepsiCo holds several minority equity interests, principally in certain franchised domestic soft drink bottlers, which are reported under the equity method of accounting. Under generally accepted accounting principles, equity in the net income of these interests is excluded from segment operating profits. To improve comparability, 1987 and 1986 net sales and operating profits have been restated to report under the equity method of accounting certain previously consolidated domestic soft drink bottling operations contributed to joint ventures in early 1988. (See Note to Consolidated Financial Statements on page 43.)

Net corporate expenses included corporate items and interest income that were not allocated to the business segments, interest expense and net foreign exchange gains. Unallocated interest income was $99 million, $90 million and $86 million, and net foreign exchange gains, which arose principally from the translation of local foreign currency borrowings, were $16 million, $2 million and $33 million in 1988, 1987 and 1986, respectively. Corporate identifiable assets principally consisted of offshore short-term investments, which have been included in the foreign portion, and minority equity interests.

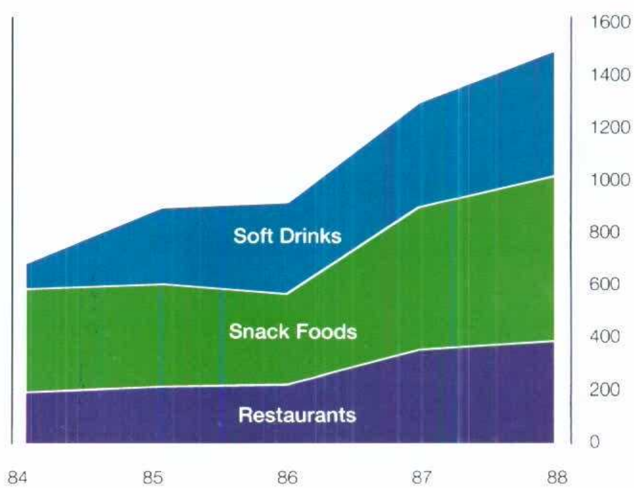
In 1987 PepsiCo adopted Financial Accounting Standard No. 87 on Employers' Accounting for Pensions. The effect was to reduce 1987 pension expense of soft drinks, snack foods, restaurants and corporate by $14 million, $25 million, $8 million and $3 million, respectively. (See Note to Consolidated Financial Statements on page 47.)

1988 consisted of 53 weeks, and 1987 and 1986 consisted of 52 weeks.

Net Sales
($ In Millions)



Operating Profits
($ In Millions)



	1988	1987	1986
Net Sales:			
Soft drinks	**$ 4,638.2**	$ 3,975.6	$3,359.8
Snack foods	**3,514.3**	3,202.0	3,018.4
Restaurants	**4,854.5**	4,188.2	2,638.9
Total continuing operations	**$13,007.0**	$11,365.8	$9,017.1
Foreign portion	**$ 2,456.4**	$ 1,970.6	$1,225.0

Income from Continuing Operations Before Income Taxes:

	1988	1987	1986
Operating profits			
Soft drinks (a)	**$ 462.9**	$ 409.6	$ 342.0
Snack foods (b)	**636.3**	547.6	342.8
Restaurants (c)	**386.3**	349.9	222.5
	1,485.5	1,307.1	907.3
Corporate expenses, net (d)	**(347.9)**	(351.6)	(216.8)
Total continuing operations	**$ 1,137.6**	$ 955.5	$ 690.5
Foreign portion of operating profits (a), (c)	**$ 183.3**	$ 143.4	$ 64.7

Capital Spending:

	1988	1987	1986
Soft drinks	**$ 198.4**	$ 202.0	$ 193.9
Snack foods	**172.6**	195.6	298.6
Restaurants	**344.2**	370.8	380.5
Corporate	**14.9**	6.6	9.2
Total continuing operations	**$ 730.1**	$ 775.0	$ 882.2
Foreign portion	**$ 132.4**	$ 145.1	$ 81.4

	1988	1987	1986
Identifiable Assets:			
Soft drinks	**$ 4,074.4**	$ 2,779.8	$2,615.9
Snack foods	**1,641.2**	1,632.5	1,596.3
Restaurants	**3,105.1**	2,782.9	2,563.1
Corporate	**2,314.6**	1,827.5	1,251.8
Total continuing operations	**$11,135.3**	$ 9,022.7	$8,027.1
Foreign portion	**$ 3,210.7**	$ 2,993.8	$2,296.2

Depreciation and Amortization Expense:

	1988	1987	1986
Soft drinks	**$ 195.7**	$ 166.5	$ 104.3
Snack foods	**156.8**	154.1	135.3
Restaurants	**271.3**	237.1	151.8
Corporate	**5.5**	5.3	4.7
Total continuing operations	**$ 629.3**	$ 563.0	$ 396.1
Foreign portion	**$ 81.9**	$ 75.8	$ 36.3

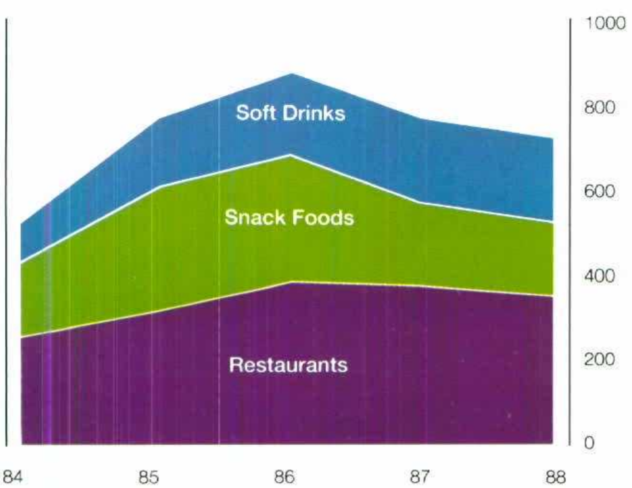
(a) 1988 included a $14.5 million charge related to the reorganization of the domestic soft drink business and a $9.4 million loss resulting from the sale of a foreign winery. 1987 included a $10.3 million gain resulting from the sale of a foreign bottling operation.

(b) 1986 included a $52.0 million charge at Frito-Lay for the discontinuance of certain non-chip snack products and reduction of cookie production capacity. 1987 included a $12.5 million favorable adjustment to the 1986 charge, primarily reflecting a $10.0 million gain resulting from the sale of a cookie production facility.

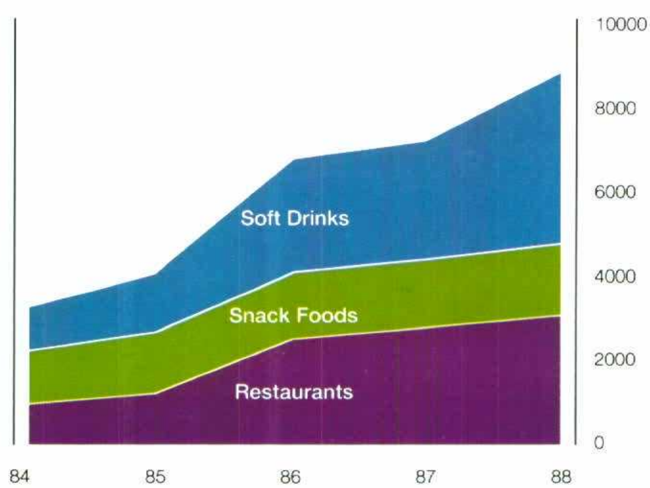
(c) 1987 included an $8.0 million charge related to the reorganization of KFC's domestic operations and a $7.5 million gain resulting from the sale of certain foreign pizza restaurants.

(d) 1986 included a $22.0 million gain arising from the favorable impact of the U.S. Tax Reform Act of 1986 on PepsiCo's Safe Harbor leases.

Capital Spending
($ In Millions)



Identifiable Assets
($ In Millions)



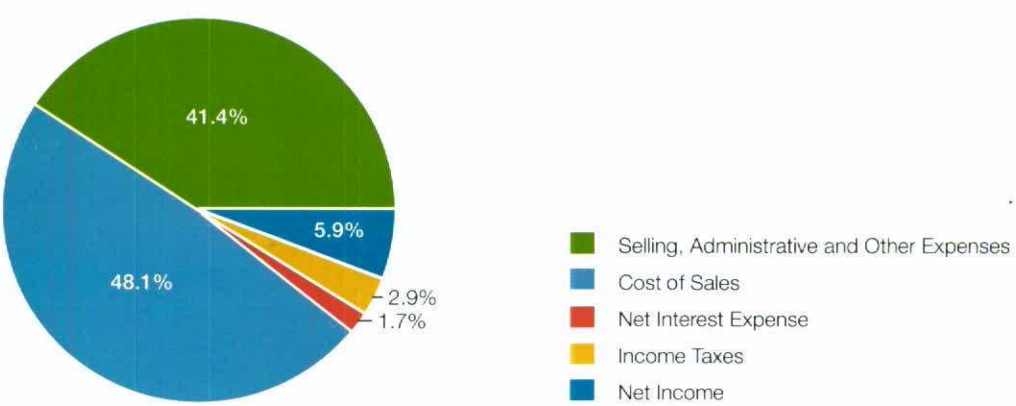
Consolidated Statement of Income

(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fifty-three weeks ended December 31, 1988 and fifty-two weeks ended December 26, 1987 and December 27, 1986

	1988	1987	1986
Net Sales	$13,007.0	$11,365.8	$9,017.1
Costs and Expenses			
Cost of sales	6,255.8	5,365.7	4,300.0
Selling, administrative and other expenses	5,391.2	4,862.5	3,887.9
Interest expense	344.9	295.8	261.4
Interest income	(122.5)	(113.7)	(122.7)
	11,869.4	10,410.3	8,326.6
Income from Continuing Operations Before Income Taxes	1,137.6	955.5	690.5
Provision for Income Taxes	375.4	350.4	226.7
Income from Continuing Operations	762.2	605.1	463.8
Discontinued Operations			
Loss from discontinued operations (net of income tax benefit of $1.3 and $6.5 in 1987 and 1986, respectively)	–	(1.3)	(6.0)
Loss on disposal (net of income tax benefit of $6.9)	–	(9.0)	–
	–	(10.3)	(6.0)
Net Income	$ 762.2	$ 594.8	$ 457.8
Income (Loss) Per Share			
Continuing operations	$2.90	$2.30	$1.77
Discontinued operations	–	(0.04)	(0.02)
Net Income Per Share	$2.90	$2.26	$1.75
Average shares outstanding used to calculate income (loss) per share	263.5	263.1	262.2

See accompanying Notes to Consolidated Financial Statements.

Allocation of 1988 Net Sales



Management's Analysis—Results of Continuing Operations

The Consolidated Statement of Income for 1987 and 1986 has been reclassified to reflect the contribution of certain soft drink bottling operations to joint ventures; also, certain restaurant operating expenses have been reclassified. These reclassifications had no effect on income from continuing operations or net income. (See Note to Consolidated Financial Statements on page 43.) The Consolidated Statement of Income for the periods presented included the results of a number of acquisitions, all of which were included from their respective dates of purchase. The acquisitions of MEI Corporation (MEI) and Seven-Up International in mid-1986 and Kentucky Fried Chicken (KFC) in late 1986 (collectively, the 1986 Acquisitions) had a particularly significant impact on comparisons of 1987 to 1986 results. Accordingly, the discussions of 1987 vs. 1986 are supplemented, where significant, with comparisons excluding the estimated first half impact of MEI and Seven-Up International from 1987 and the full impact of KFC from both years. Comparisons of 1988 to 1987 also were impacted by an additional week's results in the 1988 reporting period.

Net Sales, Costs and Expenses

Net sales rose 14% in 1988 and 26% in 1987. Excluding the 1986 Acquisitions, net sales increased 11% in 1987. The growth in both years benefited from volume gains in all three segments and new restaurant and pizza delivery units. Results in 1988 and 1987 also reflected acquisitions of franchised domestic soft drink bottlers and restaurant operators, although their relative impact was much less significant than that of the 1986 Acquisitions.

Cost of sales as a percentage of net sales was 48.1%, 47.2% and 47.7% in 1988, 1987 and 1986, respectively. The 1988 increase was due primarily to greater price discounting and higher costs in domestic soft drink bottling operations and an increase in lower gross margin distribution sales at KFC International. The 1987 improvement resulted from manufacturing efficiency gains at Frito-Lay and favorable brand sales mix in domestic soft drinks, partially offset by the impact of increased sales in the lower gross margin restaurants segment.

Selling, administrative and other expenses increased 11% in 1988 reflecting volume growth, new restaurant and pizza delivery units, and acquisitions. The 1987 increase in these expenses was 25%. Excluding the 1986 Acquisitions, the 1987 increase was 9% reflecting increased promotional spending particularly in soft drinks and restaurants, acquisitions, and new restaurant and pizza delivery units. Also affecting the change in selling, administrative and other expenses was an increase of $14 million in net foreign exchange translation gains in 1988 and a decrease of $31 million in 1987. These changes were primarily due to movements in local debt levels and exchange rates in Latin America. In 1988, 1987 and 1986, selling, administrative and other expenses included several unusual charges and gains as discussed in the Note to Consolidated Financial Statements on page 34. Excluding these unusual items, selling, administrative and other expenses increased 10% in 1988 and 11% in 1987 (excluding the 1986 Acquisitions).

Cost of sales and selling, administrative and other expenses in 1987 included a benefit of $50 million resulting from the required adoption of Financial Accounting Standard No. 87, Employers' Accounting for Pensions (SFAS 87). (See Note to Consolidated Financial Statements on page 47.)

Interest expense rose 17% in 1988 compared to 13% in 1987. The 1988 increase primarily reflected higher average domestic borrowings to finance 1988 acquisitions and increased domestic and foreign interest rates, partially offset by reduced average foreign borrowings. The 1987 increase reflected the full-year effect of financing the 1986 Acquisitions, moderated by declines in the amount of average foreign borrowings and lower domestic and foreign interest rates. Excluding the effect of the 1986 Acquisitions for the full year, interest expense would have been approximately $169 million and $207 million in 1987 and 1986, respectively.

Interest income increased 8% in 1988, compared to a 7% decline in 1987. The 1988 increase was due primarily to higher interest rates and growth in the short-term investment portfolios held in Puerto Rico. The 1987 decrease reflected lower average levels of short-term investments, lower interest rates and the effect of the 1986 collection of $11 million in interest on a foreign receivable previously written off.

Income from Continuing Operations Before Income Taxes

Income from continuing operations before income taxes increased 19% in 1988, compared to 38% in 1987. Excluding the 1986 Acquisitions, the 1987 increase was approximately 32%. The 1988 and 1987 increases resulted from double-digit profit advances in all three segments, with particularly strong improvements at Frito-Lay in 1987. The 1987 growth also benefited from the adoption of SFAS 87, as well as the impact of the unusual charges and gains in 1987 and 1986.

Provision for Income Taxes

The effective tax rates on income from continuing operations were 33%, 37% and 33% in 1988, 1987 and 1986, respectively. In 1988 the lower effective tax rate reflected the declining federal statutory tax rate provided by the U.S. Tax Reform Act of 1986 (TRA) and lower state income taxes, partially offset by increased foreign taxes. The higher effective tax rate for 1987 reflected the absence of one-time 1986 benefits and higher state income taxes, partially offset by the impact of the lower rate provided by the TRA. The effective tax rate in 1986 benefited from an $18 million reversal of previously provided deferred foreign taxes, reflecting management's decision to indefinitely reinvest certain unremitted prior years' earnings, and a nontaxable $22 million gain arising from the favorable impact of the TRA on PepsiCo's Safe Harbor leases. The declining rates provided by the TRA resulted in a 3 percentage point reduction in the effective tax rate for both 1988 and 1987.

New rules for accounting for income taxes are expected to have a favorable impact on net income when adopted in 1990. (See Note to Consolidated Financial Statements on page 46.)

Income Per Share from Continuing Operations

Income per share from continuing operations increased 26% to $2.90 in 1988, compared to a 30% increase in 1987 to $2.30. The estimated benefit of the lower effective tax rate on 1988 income per share ($0.16) was offset by the estimated impact of dilution from acquisitions ($0.09) and the unusual charges ($0.06) in 1988. For the full year, the 1986 Acquisitions contributed an estimated $0.13 to 1987 income per share compared to dilution of $0.05 in 1986.

Consolidated Statement of Financial Condition

(in millions except per share amount)
PepsiCo, Inc. and Subsidiaries
December 31, 1988 and December 26, 1987

	1988	1987
Assets		
Current Assets		
Cash and cash equivalents	$ 142.7	$ 79.3
Short-term investments, at cost which approximates market	1,475.1	1,273.3
	1,617.8	1,352.6
Notes and accounts receivable, less allowance: $55.7 in 1988 and $55.4 in 1987	979.3	885.6
Inventories	442.4	433.0
Prepaid expenses, taxes and other current assets	225.2	268.4
Total Current Assets	3,264.7	2,939.6
Investments, Long-term Receivables and Other Assets	825.7	581.4
Property, Plant and Equipment	4,462.5	4,117.4
Goodwill and Other Intangibles	2,582.4	1,384.3
Total Assets	$11,135.3	$9,022.7
Liabilities and Shareholders' Equity		
Current Liabilities		
Notes payable	$ 1,095.2	$ 480.7
Current maturities of long-term debt	355.8	165.2
Accounts payable	881.4	725.1
Income taxes payable	250.2	198.8
Other current liabilities	1,291.0	1,153.0
Total Current Liabilities	3,873.6	2,722.8
Long-term Debt	2,356.6	2,279.9
Nonrecourse Obligation	299.4	299.3
Other Liabilities and Deferred Credits	643.8	407.5
Deferred Income Taxes	800.9	804.6
Shareholders' Equity		
Capital stock, par value 1 2/3¢ per share: authorized 600.0 shares, issued 287.7 shares	4.8	4.8
Capital in excess of par value	312.2	290.5
Retained earnings	3,329.7	2,776.7
Cumulative translation adjustment	24.0	(9.8)
Cost of treasury stock: 24.9 shares in 1988, 27.3 shares in 1987	(509.7)	(553.6)
Total Shareholders' Equity	3,161.0	2,508.6
Total Liabilities and Shareholders' Equity	$11,135.3	$9,022.7

See accompanying Notes to Consolidated Financial Statements.

Management's Analysis—Financial Condition

PepsiCo's overriding objective is to increase the value of its shareholders' investment through integrated operating, investment and financial leverage strategies that optimize cash returns and reduce the cost of capital. PepsiCo estimates its current cost of capital to be 11%.

Assets

Total assets increased $2.1 billion or 23% over 1987. This increase primarily reflected acquisitions and investments in joint ventures, higher short-term investments, and purchases of property, plant and equipment.

Substantially all of PepsiCo's short-term investments consisted of marketable securities portfolios held offshore. These investments have grown with the strong operating cash flows generated by soft drink concentrate manufacturing facilities in Puerto Rico and Ireland, which operate under tax incentive grants. The investments are high grade and subject to prudent investment policy guidelines. Tax-advantaged portfolios held in Puerto Rico represent a substantial portion of the offshore investments. PepsiCo has reached an agreement in principle to amend the Puerto Rican tax incentive grant such that for a nominal tax the previously untaxed portfolios of approximately $1 billion held in Puerto Rico at year-end 1988 may be repatriated at PepsiCo's option over the subsequent three year period or later. (See Note to Consolidated Financial Statements on page 46.) PepsiCo continually reassesses its alternatives to redeploy these and its other offshore portfolios, considering other investment opportunities and tax consequences.

Investments, long-term receivables and other assets increased $244 million in 1988, due primarily to joint venture investments in domestic soft drink bottling and foreign snack foods operations. Joint venture activity continues to play an important role in PepsiCo's growth, particularly in international markets as the synergies of the foreign partners' local market knowledge and PepsiCo's operating and financial strengths create profitable growth opportunities.

PepsiCo's purchases of property, plant and equipment totaled $730 million and $775 million for 1988 and 1987, respectively, led in both years by new unit development and refurbishments of existing units in the restaurants segment. The decline from 1987 reflected fewer new units at Taco Bell and reduced spending at Frito-Lay.

Goodwill and other intangibles increased $1.2 billion over 1987, primarily reflecting the value of Pepsi-Cola franchise rights acquired with the 1988 acquisitions of several franchised domestic soft drink bottlers. (See Note to Consolidated Financial Statements on page 43.)

Liabilities

Total liabilities rose $1.5 billion or 22% over 1987, reflecting higher levels of notes payable (primarily commercial paper) and long-term debt required to finance the 1988 acquisitions. (See Note to Consolidated Financial Statements on page 45.) In February 1989 PepsiCo entered into interest rate swap agreements to effectively convert $700 million of short-term borrowings into fixed interest rate debt over the following six to nine month period; the weighted average fixed interest rate approximates the year-end 1988 weighted average interest rate for commercial paper.

At year-end 1988 the remaining net reserve for the 1984 Refranchising Program included, in part, the estimated amount required to sell (refranchise) the company-owned bottling operation in Japan. Negotiations regarding Japan have not been successful, and it is increasingly possible that PepsiCo will be unable to complete a refranchising on satisfactory terms and conditions. In that event, it is probable that PepsiCo would continue to operate the business and that a significant portion of the reserve related to Japan may not be required. The net reserve of $50 million and $51 million at year-end 1988 and 1987, respectively, was included in the Consolidated Statement of Financial Condition under the caption "Other current liabilities."

Financial Leverage

In managing its capital structure, PepsiCo seeks to utilize financial leverage to lower the overall cost of capital and increase returns to shareholders while maintaining operating and financial flexibility.

PepsiCo measures leverage on both a gross and net basis to take into account its sizeable short-term investment portfolios. On a gross basis, PepsiCo's ratio of total debt (including the nonrecourse obligation) to capital employed (total debt, other liabilities and deferred credits, deferred income taxes and shareholders' equity) rose to 47.1% at year-end 1988 from 46.4% at year-end 1987. Leverage on a net basis, which reflects the pro forma remittance (net of related taxes) of the offshore short-term investment portfolios as a reduction of total debt and which excludes the nonrecourse obligation, was approximately 37% and 35% at year-end 1988 and 1987, respectively. Because the offshore portfolios do not impact the management of operating working capital, PepsiCo believes the net debt ratio is the better measure of financial leverage used in the business. Although a net debt target range of 35% to 40% has been established, PepsiCo will exceed this range if warranted by appropriate investment opportunities such as the proposed acquisition of the franchised domestic soft drink bottling operations of General Cinema Corporation. (See Note to Consolidated Financial Statements on page 43.)

PepsiCo's negative operating working capital position, which principally reflects the cash sales nature of its restaurant operations, is an interest-free source of capital. Operating working capital, which excludes short-term investments, notes payable and current maturities of long-term debt, was a negative $633 million and $411 million at year-end 1988 and 1987, respectively.

Shareholders' Equity

Return on average shareholders' equity represents a combination of operating performance and the effect of financial leverage. Based on income from continuing operations, PepsiCo's return on average shareholders' equity was 26.9% in 1988 compared to 26.5% in 1987. The growth primarily reflects the increase in income from continuing operations.

Consolidated Statement of Cash Flows

(in millions)
PepsiCo, Inc. and Subsidiaries
Fifty-three weeks ended December 31, 1988 and fifty-two weeks ended December 26, 1987 and December 27, 1986

	1988	1987	1986
Cash Flows from Continuing Operations:			
Income from continuing operations	$ 762.2	$ 605.1	$ 463.8
Adjustments to reconcile income from continuing operations to net cash generated by continuing operations:			
Depreciation and amortization	629.3	563.0	396.1
Deferred income taxes	20.1	59.0	52.9
Other noncash charges and credits–net	213.4	105.4	58.0
Changes in:			
Notes and accounts receivable	(50.1)	(95.6)	(65.8)
Inventories	13.8	4.1	23.5
Prepaid expenses, taxes and other current assets	37.8	39.7	24.1
Accounts payable	138.2	(76.9)	112.8
Income taxes payable	55.1	23.3	44.4
Other current liabilities	74.7	107.4	102.4
Net Cash Generated by Continuing Operations	1,894.5	1,334.5	1,212.2
Cash Flows from Investment Activities:			
Acquisitions and investments	(1,415.5)	(371.5)	(1,679.9)
Purchases of property, plant and equipment	(725.8)	(770.5)	(858.5)
Proceeds from sales of property, plant and equipment	67.4	98.6	41.4
Proceeds from sales of businesses	283.2	161.6	375.7
Other short-term investments–by original maturity:			
Three months or less–net	(411.1)	(736.1)	527.3
More than three months–purchases	(692.6)	(1,311.8)	(1,302.3)
More than three months–sales	902.0	1,526.2	868.3
Other, net	(58.7)	(72.9)	66.7
Net Cash Used for Investment Activities	(2,051.1)	(1,476.4)	(1,961.3)
Cash Flows from Financing Activities:			
Proceeds from issuances of long-term debt	475.3	598.3	1,058.3
Payments of long-term debt	(190.0)	(113.4)	(233.6)
Notes payable–by original maturity:			
Three months or less–net	306.7	114.7	(30.3)
More than three months–proceeds	292.0	547.9	1,745.8
More than three months–payments	(367.4)	(1,157.0)	(1,385.8)
Proceeds from nonrecourse obligation	0.1	299.3	–
Cash dividends paid	(199.0)	(172.0)	(160.4)
Purchases of treasury stock	(71.8)	(18.6)	(158.0)
Proceeds from issuances of treasury stock	2.9	3.0	7.4
Other, net	(27.4)	(41.8)	(14.3)
Net Cash Generated by Financing Activities	221.4	60.4	829.1
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(1.4)	(8.0)	(4.9)
Net Increase (Decrease) in Cash and Cash Equivalents	63.4	(89.5)	75.1
Cash and Cash Equivalents–Beginning of Year	79.3	168.8	93.7
Cash and Cash Equivalents–End of Year	$ 142.7	$ 79.3	$ 168.8

See accompanying Notes to Consolidated Financial Statements, including "Supplemental Cash Flow Information" on page 48.

Management's Analysis—Cash Flows

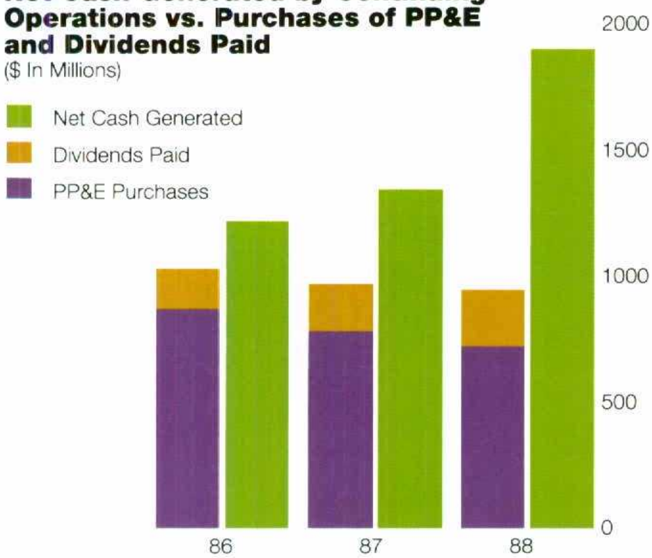
PepsiCo adopted Financial Accounting Standard No. 95, "Statement of Cash Flows" in 1988. The 1987 and 1986 cash flows have been restated to conform with the 1988 presentation. Under this new accounting standard, only the cash impact of transactions is presented in the statement. Major noncash activity related to acquisitions, capital stock issuances and purchases of property, plant and equipment (PP&E) is presented in the Note to the Consolidated Financial Statements on page 48.

Net cash generated by continuing operations again reached a record in 1988, maintaining the momentum of PepsiCo's strategic actions to stimulate growth through investments in its existing business segments and to improve operating efficiencies and cash flow returns. PepsiCo generated $1.9 billion in cash from operations, which together with $221 million in cash generated by financing activities and $283 million from sales of businesses, funded acquisitions and investments of $1.4 billion, purchases of PP&E of $726 million, and dividend payments of $199 million. Fluctuations in maturity categories of short-term investments and notes payable primarily reflected strategies anticipating interest rate movements.

Net Cash Generated by Continuing Operations

The ability to generate funds internally continues to be one of PepsiCo's most significant financial strengths. In fact, excluding the 1988 acquisitions of soft drink bottlers, in both 1988 and 1987 each business segment generated funds in excess of amounts required for its investment activities. In each of the past three years, net cash generated by continuing operations has been well in excess of amounts required to fund purchases of PP&E and dividends.

Net Cash Generated by Continuing Operations vs. Purchases of PP&E and Dividends Paid
($ In Millions)



Net cash generated by continuing operations rose $560 million or 42% in 1988 and $122 million or 10% in 1987. In addition to higher income, these improvements reflected growth in noncash charges such as depreciation and amortization associated with acquisitions. The 1988 increase in noncash charges also reflected lower net gains on asset sales and higher accruals of noncurrent liabilities. Total operating working capital fluctuations were due primarily to a decrease in accounts payable at year-end 1987.

Investment Activities

PepsiCo's investment activities over the past three years reflected strategic spending in all segments through investments in acquisitions, joint ventures and PP&E. Cash acquisitions and other investments in 1988 totaled $1.4 billion, comprised principally of franchised domestic soft drink bottlers, the largest of which were the bottling operations of Grand Metropolitan Incorporated and a 20% equity interest in Pepsi-Cola General Bottlers, Inc. Other activity included acquisitions of franchised domestic restaurant operators and an investment in a snack food joint venture in Canada. Major acquisitions are discussed in the Note to Consolidated Financial Statements on page 43.

In 1988 PepsiCo sold certain domestic company-owned bottling operations for $208 million in cash. PepsiCo will continue to manage the day-to-day operations of these bottling businesses and will receive management fees for a period of 20 years. The pre-tax gain of $112 million has been deferred and will be amortized over 20 years. The deferred gain is reflected in the Consolidated Statement of Financial Condition under the caption "Other Liabilities and Deferred Credits."

Financing Activities

Financing activities increased $161 million in 1988 over 1987, primarily as a result of debt issuances required to finance the 1988 acquisitions. The proposed acquisition of the franchised domestic soft drink bottling operations of General Cinema Corporation (see Note to Consolidated Financial Statements on page 43) will be funded initially through short-term borrowings. The ultimate funding method has not yet been determined.

In 1987 PepsiCo's Board of Directors authorized the repurchase from time to time of up to 15 million shares. Share repurchase decisions are evaluated in light of the target capital structure and other investment opportunities, and repurchase activity was not significant in 1988 and 1987.

Cash dividends declared were a record $209 million in 1988 and $175 million in 1987. PepsiCo targets a payout of approximately one-third of the prior year's earnings, thus retaining sufficient earnings to enhance productive capability and provide adequate financial resources for growth opportunities.

PepsiCo's unused credit facilities, which exist largely to support the issuances of short-term borrowings, were reduced upon a re-evaluation of needs to approximately $1.2 billion at year-end 1988 from $1.5 billion at year-end 1987. It is probable that substantial additional credit facilities will be obtained in connection with the proposed acquisition of the bottling operations of General Cinema Corporation. PepsiCo's strong financial condition provides continued access to capital markets throughout the world.

U.S. Tax Reform Act of 1986 (TRA)

The TRA will continue to have a modest favorable impact on PepsiCo's annual cash flow, as cash savings from reduced tax rates on domestic income are partially offset by the repeal of the investment tax credit. As a result of reduced rates provided by the TRA, future taxes to be paid related to PepsiCo's Safe Harbor leases were reduced substantially beginning in 1987. (See Note to Consolidated Financial Statements on page 46.)

Consolidated Statement of Shareholders' Equity

(shares in thousands, dollars in millions, except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fifty-three weeks ended December 31, 1988 and fifty-two weeks ended December 26, 1987 and December 27, 1986

	Capital Stock				Capital		Cumulative	
	Issued		Treasury		in Excess	Retained	Translation	
	Shares	Amount	Shares	Amount	of Par Value	Earnings	Adjustment	Total
Shareholders' Equity, December 28, 1985	287,694	$ 4.8	(24,576)	$(470.1)	$282.5	$2,061.4	$(40.9)	$1,837.7
1986 Net income						457.8		457.8
Cash dividends declared (per share–$0.63)						(162.6)		(162.6)
Shares reissued to Payroll-based Employees Stock Ownership Plan (PAYSOP)			173	3.5	1.1			4.6
Payment of compensation awards and exercise of stock options			577	11.6	(2.4)			9.2
Conversion of debentures			1,421	28.5	0.1			28.6
Translation adjustments (net of income taxes of $0.6)							0.9	0.9
Purchase of treasury stock			(6,725)	(158.0)				(158.0)
Shares issued in connection with an acquisition			1,755	35.2	5.7			40.9
Shareholders' Equity, December 27, 1986	287,694	4.8	(27,375)	(549.3)	287.0	2,356.6	(40.0)	2,059.1
1987 Net income						594.8		594.8
Cash dividends declared (per share–$0.67)						(174.7)		(174.7)
Shares reissued to PAYSOP			139	2.7	2.6			5.3
Payment of compensation awards and exercise of stock options			332	6.7	2.7			9.4
Conversion of debentures			244	4.9	(1.8)			3.1
Translation adjustments ($0 tax effect)							30.2	30.2
Purchase of treasury stock			(621)	(18.6)				(18.6)
Shareholders' Equity, December 26, 1987	287,694	4.8	(27,281)	(553.6)	290.5	2,776.7	(9.8)	2,508.6
1988 Net income						762.2		762.2
Cash dividends declared (per share–$0.80)						(209.2)		(209.2)
Shares reissued to Employee Stock Ownership Plan			122	2.5	1.6			4.1
Payment of compensation awards and exercise of stock options			324	6.6	0.5			7.1
Conversion of debentures			1,015	20.7	(2.6)			18.1
Translation adjustments ($0 tax effect)							33.8	33.8
Purchase of treasury stock			(2,066)	(71.8)				(71.8)
Shares issued in connection with acquisitions			3,003	85.9	22.2			108.1
Shareholders' Equity, December 31, 1988	**287,694**	**$ 4.8**	**(24,883)**	**$(509.7)**	**$312.2**	**$3,329.7**	**$ 24.0**	**$3,161.0**

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(in millions except share amounts)

Summary of Significant Accounting Policies

Principles of Consolidation. The financial statements reflect the consolidated accounts of PepsiCo, Inc. and its wholly-owned subsidiaries and certain joint ventures controlled by Kentucky Fried Chicken. Other investments in affiliates owned 50% or less over which PepsiCo exercises significant influence are accounted for by the equity method, and the equity in net income is included in the Consolidated Statement of Income under the caption "Selling, administrative and other expenses." The Consolidated Statement of Income for 1987 and 1986 has been reclassified to report under the equity method of accounting the results of certain previously consolidated domestic soft drink bottling operations contributed to joint ventures in early 1988. Although the equity interests and previously consolidated operations are not significant to the Consolidated Financial Statements of PepsiCo, the reclassification is intended to improve comparability of PepsiCo's operating results. The reclassification had no effect on income from continuing operations or net income. All significant intercompany accounts and transactions were eliminated.

Goodwill and Other Intangibles. Goodwill and other intangibles reflect the excess of purchase price over the fair value of identifiable net assets of companies acquired and consist primarily of franchise rights related to the acquisitions of franchised domestic soft drink bottling operations. Goodwill and other intangibles are amortized on a straight-line basis over appropriate periods not exceeding 40 years. Amortization included in the Consolidated Statement of Income under the caption "Selling, administrative and other expenses" in 1988, 1987 and 1986 was $72 million, $57 million and $29 million, respectively. Accumulated amortization was $209 million and $140 million at year-end 1988 and 1987, respectively.

Marketing Costs. Marketing costs are included in the Consolidated Statement of Income under the caption "Selling, administrative and other expenses." Costs of materials in inventory and prepayments are deferred, and certain promotional discounts are expensed as incurred. All other costs of advertising and other marketing and promotional programs are charged to expense ratably over the year in which incurred, generally in relation to sales.

Classification of Restaurant Operating Expenses. Operating expenses incurred at the restaurant and delivery store level consist primarily of food and related packaging costs, labor associated with food preparation and customer service and overhead expenses. Prior to 1988 for restaurant operations, only food and packaging costs were included in the Consolidated Statement of Income under the caption "Cost of sales." As a result of a review of industry reporting practice and internal performance analyses, PepsiCo determined that also classifying all labor-related expenses as cost of sales would result in a more representative and relevant portrayal of costs of products sold in restaurant operations. Accordingly, the amounts reclassified in the Consolidated Statement of Income from "Selling, administrative and other expenses" to "Cost of sales" were $1.159 billion, $981 million and $637 million in 1988, 1987 and 1986, respectively, with no resultant impact on income from continuing operations or net income.

Statement of Cash Flows. PepsiCo adopted Financial Accounting Standard No. 95, "Statement of Cash Flows" in 1988. The 1987 and 1986 cash flows have been restated to conform with the 1988 presentation. Cash equivalents are comprised of funds temporarily invested (with original maturities not exceeding three months) as part of PepsiCo's management of day-to-day operating cash receipts and disbursements. All other investment portfolios, which are primarily held offshore, were classified as short-term investments.

Net Income Per Share. Net income per share is computed by dividing net income (adjusted for interest expense related to certain convertible debentures) by the weighted average number of shares and share equivalents outstanding during each year. The conversion of all convertible debentures would not result in a material dilution.

Research and Development Expenses. Research and development expenses were $93 million, $83 million and $82 million in 1988, 1987 and 1986, respectively.

Acquisitions and Investments

During 1988 PepsiCo acquired a number of businesses and minority equity interests with purchase prices aggregating approximately $1.8 billion, principally comprised of over $1.4 billion in cash, $220 million in notes and $108 million in PepsiCo Capital Stock. The majority of these acquisitions were franchised domestic soft drink bottlers, the largest of which were the bottling operations of Grand Metropolitan Incorporated acquired on August 4, 1988 for approximately $705 million in cash and a 20% equity investment in Pepsi-Cola General Bottlers, Inc. (the remaining equity of which is owned by Whitman Corporation) acquired on December 31, 1987 for approximately $177 million in cash and certain previously consolidated bottling operations with an aggregate carrying value of approximately $17 million.

Acquisition activity in 1986 included the October acquisition of the Kentucky Fried Chicken operations for $841 million in cash, the May acquisition of the domestic soft drink bottling operations of MEI Corporation for $591 million in cash and the July acquisition of the international franchise soft drink business and certain Canadian bottling operations of The Seven-Up Company for $246 million in cash. Consistent with management's intention in 1986, the Canadian bottling operations were sold in 1988 and 1987 to franchised bottlers for a total of approximately $66 million in cash. No gains or losses resulted from the sales.

The business acquisitions have been accounted for by the purchase method; accordingly, their results were included in the Consolidated Financial Statements from their respective dates of acquisition. The 1988 purchase prices have been preliminarily allocated to the estimated fair value of the assets acquired and liabilities assumed. Goodwill and other intangibles recorded in connection with the 1988 acquisitions was $1.3 billion.

The following table presents the unaudited pro forma combined results of PepsiCo and the aforementioned 1986 acquisitions as if they had occurred at the beginning of that year and a substantial majority of the 1988 acquisitions had they occurred at the beginning of 1988 and 1987. The aggregate impact of other acquisitions in the periods presented was not material to PepsiCo's net sales, income or income per share; accordingly, no related pro forma information is provided. The pro forma information does not necessarily represent what the actual consolidated results would have been for these periods and is not intended to be indicative of future results.

	1988	1987	1986
Net sales	$13,343.2	$11,797.7	$10,486.3
Income from continuing operations	$ 744.4	$ 569.0	$ 461.1
Per share	$ 2.83	$ 2.17	$ 1.76
Net income	$ 744.4	$ 558.7	$ 455.1
Per share	$ 2.83	$ 2.13	$ 1.74

In February 1989 PepsiCo entered into an agreement to acquire the franchised domestic soft drink bottling operations of General Cinema Corporation for approximately $1.75 billion in cash, subject to certain adjustments. The closing date has not yet been established, and the acquisition is subject to review by the Federal Trade Commission. The unaudited pro forma dilution of PepsiCo's 1988 income per share, had the acquisition occurred at the beginning of 1988, is estimated at an additional $0.20.

Discontinued Operations

In 1987 PepsiCo sold La Petite Boulangerie, Inc. (LPB), a retail bakery operation, for $15 million in cash. The sale produced a loss of $16 million before-tax and $9 million after-tax ($0.03 per share). The 1987 loss on the sale of LPB was reflected in the Consolidated Statement of Income under the caption "Loss on disposal." The results of the operations of LPB, through the date of sale, were included in the Consolidated Statement of Income under the caption "Loss from discontinued operations." LPB's net sales were $15 million through the date of sale in 1987 and $43 million in 1986.

Inventories

Inventories are valued at the lower of cost (computed on the average, first-in, first-out or last-in, first-out methods) or net realizable value. Inventories computed on the last-in, first-out (LIFO) method comprised 56% and 57% of inventories at year-end 1988 and 1987, respectively.

	1988	1987
Raw materials, supplies and in-process	$237.6	$241.7
Finished goods	220.0	201.4
Total (approximates current cost)	457.6	443.1
Excess of current cost over LIFO cost	(15.2)	(10.1)
	$442.4	$433.0

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally on a straight-line basis over the estimated useful lives of the assets. Interest capitalized as an additional cost of property, plant and equipment was $2 million in 1988, $5 million in 1987 and $11 million in 1986.

	1988	1987
Land	$ 568.9	$ 500.9
Buildings and building improvements	2,118.7	1,949.5
Machinery and equipment	3,764.2	3,352.2
Capital leases, primarily buildings	206.6	198.0
	6,658.4	6,000.6
Accumulated depreciation and amortization	(2,195.9)	(1,883.2)
	$4,462.5	$4,117.4

Leases

PepsiCo has noncancelable commitments under both capital and operating leases, primarily for restaurant units. Certain of these units have been subleased to restaurant franchisees. Lease commitments on capital and operating leases expire at various dates through 2022.

Future minimum lease commitments and sublease receivables under noncancelable leases:

	Commitments		Sublease Receivables	
	Capital	Operating	Direct Financing	Operating
1989	$ 27.9	$ 152.7	$ 6.8	$ 8.5
1990	26.9	140.7	6.6	8.1
1991	24.8	130.4	6.6	7.7
1992	22.9	123.6	6.6	7.3
1993	21.8	117.1	6.5	7.2
Later years	118.3	596.1	36.2	47.4
	$242.6	$1,260.6	$69.3	$86.2

At year-end 1988 the present value of minimum lease payments for capital leases was $144 million, after deducting $1 million for estimated executory costs (taxes, maintenance and insurance) and $98 million representing imputed interest. The present value of minimum sublease receivables was $38 million after deducting $31 million of unearned interest income.

Rental expense and income under operating leases and subleases, respectively:

	Rental	
	Expense	Income
1988	$240.0	$13.2
1987	204.8	16.6
1986	147.2	17.1

Notes Payable and Long-term Debt

	1988	1987
Notes Payable		
Commercial paper	$ 757.9	$ 273.3
Other notes payable	337.3	207.4
	$1,095.2	$ 480.7
Long-term Debt		
Commercial paper (7.4% weighted average interest rate at year-end 1987) **(A)**	$ –	$ 150.0
Notes due 1989 through 1998 (7.9% and 7.5% weighted average interest rate at year-end 1988 and 1987, respectively) **(B)**	1,078.2	949.8
Zero coupon notes (various), $1.1 billion due 1989-2012 (14.0% and 14.1% semi-annual weighted average yield to maturity at year-end 1988 and 1987, respectively)	274.4	238.8
European Currency Units 7⅝% and 7⅞% notes due 1990 and 1992 **(C)**	234.4	126.5
Swiss franc perpetual Foreign Interest Payment bonds **(D)**	208.3	207.6
Australian dollar notes due 1989 and 1990 (13.6% weighted average interest rate at year-end 1988 and 1987) **(C)**	148.6	124.5
Pound sterling 9⅛% notes due 1993 **(C)**	108.5	–
Swiss franc 5¼% bearer bonds due 1995 **(C)**	87.2	99.1
Italian lire 10½% notes due 1991 **(C)**	76.4	83.7
Canadian dollar 8¾% notes due 1991 **(B)**	62.6	57.0
New Zealand dollar 18½% notes due 1989 **(C)**	37.8	39.1
Capital lease obligations	144.2	143.2
Other, due 1989-2014 (8.5% and 10.8% weighted average interest rate at year-end 1988 and 1987, respectively)	251.8	225.8
	2,712.4	2,445.1
Less current maturities of long-term debt	355.8	165.2
Total long-term debt **(E)(F)**	$2,356.6	$2,279.9

For additional information on capital lease obligations, see Note on page 44.

(A) At year-end 1988 and 1987 PepsiCo had revolving credit agreements aggregating $1.2 billion and $1.5 billion, respectively, covering potential borrowings through 1992. These unused credit facilities provide PepsiCo with the ability to refinance short-term borrowings and support the classification of commercial paper as long-term debt when it is PepsiCo's intent to refinance such commercial paper on a long-term basis as at year-end 1987.

(B) PepsiCo has utilized interest rate swap agreements to effectively convert $733 million of fixed interest rate long-term debt to variable rate long-term debt with a weighted average interest rate of 8.7% at year-end 1988.

(C) PepsiCo has entered into currency exchange agreements to hedge its foreign currency exposure on these issues of non-U.S. dollar denominated debt. At year-end 1988 the agreements effectively established U.S. dollar liabilities of $160 million with a weighted average fixed interest rate of 8.6%, and $450 million with a weighted average variable interest rate of 8.2%.

(D) The coupon rate of the Swiss franc 400 million perpetual Foreign Interest Payment bonds, issued in 1986, is 7½% through 1996. The principal of the bonds is payable in Swiss francs and the interest payments will be made in U.S. dollars at a fixed contractual exchange rate. At the end of each 10-year period after the issuance of the bonds: (i) PepsiCo will have the right to redeem the bonds at their face amount; (ii) the bondholders will have the right to cause PepsiCo to redeem the bonds at the lesser of their face amount or the Swiss franc equivalent of the U.S. dollar proceeds received at issuance (the proceeds amount); or (iii) if the bonds are not redeemed, the coupon rate will be adjusted based on the prevailing yield of 10-year U.S. Treasury Securities. As it is PepsiCo's intent not to redeem the bonds, the proceeds amount is the basis of the carrying value of the bonds in the Statement of Financial Condition.

(E) In 1984 PepsiCo issued $104 million Deutsche mark denominated bearer bonds yielding 7¼%, due 1994 and callable beginning in 1989. PepsiCo defeased the bonds in 1984 by depositing higher yielding notes of the West German Government in an irrevocable trust established for the sole purpose of servicing the scheduled interest and principal payments on the bonds. The bonds and West German Government notes were not included in the Consolidated Statement of Financial Condition. As a result of changes in West German tax laws, the bonds were called and will be redeemed in early 1989.

(F) Long-term debt is carried net of any related discount or premium and unamortized debt issuance costs. Foreign currency denominated debt has been valued in the Consolidated Statement of Financial Condition at year-end exchange rates. The annual maturities of long-term debt through 1993, excluding capital lease obligations, are: 1989–$343 million; 1990–$294 million; 1991–$369 million; 1992–$201 million and 1993–$576 million. The debt agreements include various restrictions, none of which is presently significant to PepsiCo.

Nonrecourse Obligation

In 1987 PepsiCo entered into an agreement related to a nonrecourse obligation (the Obligation) under which it received proceeds of $299 million, net of related expenses. The Obligation and related interest are payable solely from future royalty payments from certain independent domestic franchisees of one of PepsiCo's restaurant systems, for a period not to exceed 10 years. The Obligation carries a variable interest rate (8.9% as of December 31, 1988) based upon a commercial paper rate. Under the terms of the agreement, principal repayments during the first three years can be readvanced; as it is PepsiCo's intent to elect this provision, the entire Obligation is considered noncurrent. Principal repayments, net of amounts readvanced, are estimated to be $260 million over the next five years.

Income Taxes

Provision for income taxes on income from continuing operations:

	1988	1987	1986
Current – Federal	$235.2	$226.8	$139.9
Foreign	61.9	28.9	10.8
State	40.6	22.5	19.2
	337.7	278.2	169.9
Deferred – Federal	37.4	32.9	58.6
Foreign	3.0	(2.2)	(15.2)
State	(2.7)	41.5	13.4
	37.7	72.2	56.8
	$375.4	$350.4	$226.7

U.S. and foreign income from continuing operations before income taxes:

	1988	1987	1986
U.S.	$ 773.4	$605.6	$398.1
Foreign	364.2	349.9	292.4
	$1,137.6	$955.5	$690.5

Consistent with the allocation for tax purposes, approximately 50% of the income arising from the sale of soft drink concentrates that are manufactured in Puerto Rico is included in Foreign in the above table. PepsiCo has soft drink concentrate manufacturing facilities in Ireland and Puerto Rico that operate under tax incentive grants expiring in 1989 and 1991, respectively. Upon expiration of the Irish tax incentive grant, the concentrate manufacturing profits will be subject to a 10% tax. Further, PepsiCo has reached an agreement in principle to amend its tax incentive grant related to Puerto Rico. Under the terms of the agreement, for a nominal tax the previously untaxed earnings of approximately $1 billion held in Puerto Rico as of December 31, 1988 may be repatriated at PepsiCo's option over the subsequent three year period or later. Earnings in Puerto Rico subsequent to December 31, 1988, whether or not repatriated, will be subject to a tax of approximately 7% in 1990 and beyond and a reduced tax in 1989. The amendment to the grant will expire in 2006. The future taxes related to the Irish and Puerto Rican tax incentive grants are not expected to have a material impact on net income or cash flows.

The deferred income tax provision, which results from differences in the timing of recognition of revenue and expense for financial reporting and tax purposes, arose from the following:

	1988	1987	1986
Depreciation	$ 44.0	$ 66.5	$ 64.4
Investment tax credits	(14.6)	(15.1)	(13.4)
Disposals of foreign bottling operations	1.6	2.5	25.3
Discontinued product costs	1.5	10.2	(23.6)
Other, net	5.2	8.1	4.1
	$ 37.7	$ 72.2	$ 56.8

Deferred taxes were not provided on unremitted earnings of subsidiaries operating outside the United States that are intended to be indefinitely reinvested. These unremitted earnings aggregated approximately $473 million at year-end 1988, exclusive of amounts that if remitted in the future would result in little or no tax under current tax laws and the amended Puerto Rican tax incentive grant. In 1986 PepsiCo reversed previously provided deferred foreign taxes of $18 million, reflecting management's decision to indefinitely reinvest certain unremitted prior years' foreign earnings.

Reconciliation of the U.S. federal statutory tax rate to PepsiCo's effective tax rate on income from continuing operations:

	1988	1987	1986
U.S. federal statutory tax rate	34.0%	40.0%	46.0%
State income tax net of federal tax benefit	2.2	4.2	2.6
Earnings in jurisdictions taxed at lower rates (principally Puerto Rico and Ireland)	(3.1)	(7.2)	(10.2)
Investment and targeted jobs tax credits	(1.6)	(2.2)	(2.9)
Deferred taxes no longer required on unremitted earnings	–	–	(2.5)
Other, net	1.5	1.9	(0.2)
Effective tax rate	33.0%	36.7%	32.8%

Deferred income taxes reflected in the Consolidated Statement of Financial Condition were comprised of the following:

	1988	1987
Deferred Income Taxes:		
Taxes payable		
– Timing differences	$529.6	$507.3
– Safe Harbor leases	236.3	247.7
Investment tax credits	35.0	49.6
	$800.9	$804.6
Deferred income taxes included in "Prepaid expenses, taxes and other current assets"	$ 20.4	$ 53.7

The U.S. Tax Reform Act of 1986 (TRA) reduced the provision for income taxes by an estimated $30 million in 1987 and an additional $38 million in 1988, primarily reflecting the declining federal statutory tax rate, but had an insignificant impact on the 1986 provision for income taxes. The repeal of the investment tax credit (ITC) by the TRA had a modest impact on PepsiCo's 1988, 1987 and 1986 effective tax rate because PepsiCo amortizes the benefit of ITC for financial reporting purposes over the estimated useful lives of the related assets.

In 1981 and 1982 PepsiCo invested in Safe Harbor leases (the Leases), which effectively are financing transactions that decrease income taxes payable over the initial years of the Leases and increase them over the later years. In 1986 deferred federal income taxes payable related to the Leases were reduced by $90 million as a result of the lower federal statutory tax rates for 1987 and subsequent years provided by the TRA. A $22 million gain, representing the reduction in the deferred tax liability net of the remaining investment in the Leases, was included

in the 1986 Consolidated Statement of Income under the caption "Selling, administrative and other expenses." Taxes payable related to the Leases are estimated to be $64 million over the next five years.

In December 1988 the Financial Accounting Standards Board amended Statement No. 96 on Accounting for Income Taxes (SFAS 96) to extend the required adoption date by one year. PepsiCo will adopt SFAS 96 as required in the first quarter of 1990. The adoption of SFAS 96 will impact PepsiCo's deferred income taxes payable related to timing differences as well as the amount included in "Prepaid expenses, taxes and other current assets." Assuming continued reduced tax rates as provided by the TRA, the adoption of SFAS 96 on a prospective basis is expected to have a favorable impact on net income. This benefit would result from a reduction in net deferred income taxes to amounts estimated to be paid in future years, partially offset by the recording of deferred tax liabilities related to previously consummated acquisitions.

Retirement Plans

PepsiCo has several noncontributory defined benefit pension plans covering substantially all full-time domestic employees. Generally, benefits for salaried employees are based on years of service and the employees' highest consecutive five-year average annual earnings. Benefits for hourly employees are based on specified amounts and credited service. PepsiCo funds these plans in amounts not less than minimum statutory funding requirements nor more than the maximum amount which can be deducted for federal income tax purposes. The plan assets consist principally of equity securities, government and corporate debt securities and other fixed income obligations. Capital Stock of PepsiCo accounted for approximately 12.5% and 12.0% of the total market value of plan assets at year-end 1988 and 1987, respectively.

Effective December 28, 1986, PepsiCo adopted Financial Accounting Standard No. 87 (SFAS 87), on Employers' Accounting for Pensions, for all company-sponsored domestic plans. The effect of adopting SFAS 87 was a reduction in 1987 pension expense of $50 million. As required by SFAS 87, pension expense for all domestic plans in 1986 was determined under the provisions of previous accounting principles.

Pension expense for company-sponsored domestic plans (the Plans) was a credit of $16.8 million and $11.5 million in 1988 and 1987, respectively, and a charge of $32.2 million for 1986. The decrease in 1987 resulted principally from the adoption of SFAS 87.

The net pension credit for the Plans included the following:

	1988	1987
Service cost of benefits earned during the year	**$ 24.8**	$ 29.5
Interest cost on projected benefit obligations	**40.0**	38.1
Return on the Plans' assets:		
Actual	**(86.1)**	(50.9)
Deferred gain (loss)	**23.5**	(9.2)
	(62.6)	(60.1)
Amortization of net transition gain	**(19.0)**	(19.0)
Pension credit	**$(16.8)**	$(11.5)

In determining the 1988 and 1987 pension credits, the assumed discount rates were 10.0% and 8.6%, respectively, and the expected long-term rate of return applied to the market-related value of the Plans' assets was 10.0% for both years.

Reconciliations of the funded status of the Plans to the accrued pension liability included in the Consolidated Statement of Financial Condition are as follows:

	Plans with Assets Exceeding Accumulated Benefits		Plans with Accumulated Benefits Exceeding Assets	
	1988	1987	1988	1987
Actuarial present value of benefit obligations:				
Vested benefits	**$(310.0)**	$(266.1)	**$(4.0)**	$(4.4)
Nonvested benefits	**(72.7)**	(65.6)	**(0.6)**	(0.8)
Accumulated benefit obligation	**(382.7)**	(331.7)	**(4.6)**	(5.2)
Effect of projected compensation increases	**(54.9)**	(68.4)	**(2.1)**	(2.2)
Projected benefit obligation	**(437.6)**	(400.1)	**(6.7)**	(7.4)
Plan assets at fair value	**708.5**	646.5	**–**	0.4
Plan assets in excess of (less than) projected benefit obligation	**270.9**	246.4	**(6.7)**	(7.0)
Unamortized prior service cost	**3.4**	0.4	**–**	–
Unamortized net gain	**(96.0)**	(76.7)	**(1.1)**	(1.5)
Unamortized net transition (gain) loss	**(186.8)**	(205.9)	**0.7**	0.8
Accrued pension liability	**$ (8.5)**	$ (35.8)	**$(7.1)**	$(7.7)
Included in:				
Investments, Long-term Receivables and Other Assets	**$ 3.4**	$ –	**$ –**	$ –
Other current liabilities	**$ (10.8)**	$ (4.4)	**$ –**	$(0.2)
Other Liabilities and Deferred Credits	**$ (1.1)**	$ (31.4)	**$(7.1)**	$(7.5)

The determination of the actuarial present value of the projected benefit obligation at year-end 1988 and 1987 reflected assumed discount rates of 10.1% and 10.0%, respectively, and future compensation growth rates within a range of 5.0% to 7.0% for both years.

Domestic employees not covered by the Plans are generally covered by multiemployer plans as part of collective-bargaining agreements. Pension expense for these multiemployer plans was not significant in the aggregate.

Pension coverage for employees of PepsiCo's foreign operations is provided through separate plans, many of which are governed by local statutory requirements. These plans are not significant in the aggregate and therefore are not included in the above disclosures.

PepsiCo provides certain health care and life insurance benefits to retired nonunion employees. Annual costs of the benefits are expensed as health care claims are incurred and life insurance premiums are paid and are currently not significant.

Management Incentive Plan

The shareholder-approved 1987 Incentive Plan (the Plan), effective January 1, 1988, continues the principal features of the 1979 Incentive Plan that expired on December 31, 1987. The Plan provides long-term incentives to key employees through stock options, performance shares and stock appreciation rights (SARs) awarded to senior management employees, and through incentive stock units (Units) awarded to middle management employees. The Plan authorizes up to a maximum of 18 million shares of PepsiCo Capital Stock to be purchased or paid pursuant to grants by the Compensation Committee of the Board of Directors (the Committee). Payment of awards, other than stock options, is made in cash and/or PepsiCo Capital Stock as determined by the Committee, which is composed of outside directors.

A stock option represents the right to purchase one share of PepsiCo Capital Stock at the fair market value when granted for a specified period generally falling between 4 and 15 years from the date of grant. A performance share, which is equivalent to one share of PepsiCo Capital Stock, vests and is payable four years after the date of grant, contingent upon attainment of prescribed performance criteria. A partial performance share award is granted to an employee who subsequently becomes eligible or is promoted. A stock option is granted with each performance award, which prior to 1988 consisted of a performance share. Beginning with the 1988 award, a specified number of additional stock options are granted as a performance award in lieu of a performance share. These additional stock options may subsequently be converted to a performance share at the employee's election within 60 days from the date of grant.

SARs, available to certain employees holding stock options, are granted in the year the related options become exercisable. They allow the employees to surrender an option for an amount equal to the appreciation between the option exercise price and the fair market value of PepsiCo Capital Stock on the date the SAR is exercised. SARs expire no later than the expiration date of the related options. During 1988, 328,755 SARs were granted. In 1989, 146,052 SARs expired, as beginning in that year the employees may elect to convert a maximum of 30% of their eligible exercisable stock options to SARs.

A Unit, which is equivalent to one share of PepsiCo Capital Stock, vests over a six-year period from the date of grant, and the value is based on the fair market value of PepsiCo Capital Stock at specified vesting dates.

The fair market value of PepsiCo Capital Stock related to the awards is determined as the lesser of the market value on the day prior to the grant or vesting date or the average market value over the 30 days preceding the grant or vesting date.

The estimated costs of performance shares, SARs and Units, which are expensed over the applicable vesting periods of the awards, were $16 million, $20 million and $17 million in 1988, 1987 and 1986, respectively.

Award activity under PepsiCo's management incentive plan for 1988 was as follows:

	Stock Options	Performance Shares	Incentive Stock Units
Outstanding at December 26, 1987	3,142,243	1,769,233	562,284
Granted	3,683,948	87,249	7,181
Exercised/paid	(194,430)	(1,017,864)	(15,034)
Surrendered for performance shares	(542,130)	180,710	–
Surrendered for SARs	(116,417)	–	–
Cancelled	(146,688)	(46,702)	(96,296)
Outstanding at December 31, 1988	5,826,526	972,626	458,135
Exercisable at December 31, 1988	798,844		

Option prices per share
Exercised during the year ....$12.33 to $26.25
Outstanding at year-end...............$12.33 to $37.65

Supplemental Cash Flow Information

	1988	1987	1986
Cash Flow Data:			
Interest paid	$286.5	$257.7	$221.6
Income taxes paid	$234.7	$222.2	$ 84.0
Schedule of Noncash Investment and Financing Activities:			
Issuances of treasury stock and debt for acquisitions	$328.2	$ –	$ 40.9
Liabilities assumed/disposed of in connection with acquisitions/sales of businesses	$300.0	$ 45.0	$416.0
Issuances of treasury stock for compensation awards and conversion of debentures	$ 26.4	$ 14.8	$ 35.0
Additions of capital leases	$ 4.3	$ 4.5	$ 23.7

Contingencies

PepsiCo is involved in various claims and legal proceedings, the resolution of which management believes will not have a material effect on PepsiCo's business or financial condition. PepsiCo intends to prosecute or defend vigorously, as the case may be, all such matters.

At year-end 1988 PepsiCo was contingently liable under direct and indirect guarantees aggregating $73 million.

Management's Responsibility For Financial Statements

To Our Shareholders:

Management is responsible for the preparation, integrity and objectivity of the consolidated financial statements and related notes. To meet these responsibilities, we maintain a system of internal control, supported by formal policies and procedures, which include an active Code of Conduct program intended to ensure key employees adhere to the highest standards of personal and professional integrity. PepsiCo's internal audit function monitors and reports on the adequacy of and compliance with our internal controls, policies and procedures. Although no cost effective internal control system will preclude all errors and irregularities, we believe the established system of internal control provides reasonable assurance that assets are safeguarded, transactions are recorded in accordance with our policies and the financial information is reliable.

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis, except for the required 1987 change in the method of accounting for pensions as described in the Note to Consolidated Financial Statements appearing on page 47, and include amounts based upon our estimates and judgments, as required. The consolidated financial statements have been audited by Arthur Young & Company who have expressed their opinion, presented below, with respect to the fairness of the statements. Their audits included a review of the system of internal control and tests of transactions to the extent they considered necessary to render their opinion.

The Audit Committee of the Board of Directors is composed solely of outside directors. The Audit Committee meets periodically with Arthur Young & Company, our internal auditors and PepsiCo management to review accounting, auditing, internal control and financial reporting matters. Both Arthur Young & Company and our internal auditors have free access to the Audit Committee.

Wayne Calloway

D. Wayne Calloway
Chairman of the Board and Chief Executive Officer

Robert G Dettmer

Robert G. Dettmer
Executive Vice President and Chief Financial Officer

Robert L Carleton

Robert L. Carleton
Senior Vice President and Controller

Report of Independent Public Accountants

Board of Directors and Shareholders
PepsiCo, Inc.

We have audited the accompanying consolidated statement of financial condition of PepsiCo, Inc. and subsidiaries at December 31, 1988 and December 26, 1987, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1988, appearing on pages 34, 35, 36, 38, 40, 42 through 48. These financial statements are the responsibility of PepsiCo, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PepsiCo, Inc. and subsidiaries at December 31, 1988 and December 26, 1987, and the consolidated results of operations and cash flows for each of the three years in the period ended December 31, 1988 in conformity with generally accepted accounting principles.

As discussed in the Note to Consolidated Financial Statements appearing on page 47, PepsiCo, Inc. changed the method of accounting for pensions in 1987.

Arthur Young & Company

277 Park Avenue
New York, New York
February 7, 1989

Selected Financial Data

(in millions except per share, shareholder and employee amounts, unaudited)
PepsiCo, Inc. and Subsidiaries

	Growth Rates: Compounded 10-Year 1978-88	Growth Rates: Compounded 5-Year 1983-88	Growth Rates: Annual 1-Year 1987-88	1988	1987(a)
Summary of Operations					
Net sales	14.0%	14.6%	14.4%	$13,007.0	$11,365.8
Cost of sales and operating expenses				11,647.0	10,228.2
Interest expense				344.9	295.8
Interest income				(122.5)	(113.7)
				11,869.4	10,410.3
Income from continuing operations before income taxes				1,137.6	955.5
Provision for income taxes				375.4	350.4
Income from continuing operations	13.8%	22.0%	26.0%	$ 762.2	$ 605.1
Net income	13.1%	21.8%	28.1%	$ 762.2	$ 594.8
Income per share from continuing operations	14.5%	23.7%	26.1%	$ 2.90	$ 2.30
Net income per share	13.7%	23.7%	28.3%	$ 2.90	$ 2.26
Average shares and equivalents outstanding				263.5	263.1
Cash dividends declared	9.0%	6.7%	19.8%	$ 209.2	$ 174.7
Per share	9.4%	8.2%	19.4%	$ 0.800	$ 0.670
Year-End Position					
Total assets				$11,135.3	$ 9,022.7
Long-term debt(e)				$ 2,656.0	$ 2,579.2
Shareholders' equity				$ 3,161.0	$ 2,508.6
Per share	9.6%	13.5%	24.8%	$ 12.03	$ 9.63
Market price per share	16.6%	25.4%	16.6%	$ 39½	$ 33⅞
Shares outstanding				262.8	260.4
Employees				235,000	225,000
Shareholders of record				94,000	92,000
Statistics					
Return on average shareholders' equity(f)				26.9%	26.5%
Return on net sales(f)				5.9%	5.3%
Total debt to total capital employed(g)				47.1%	46.4%

The above amounts have been restated to reflect the divestiture of La Petite Boulangerie and the reclassifications to report under the equity method of accounting certain previously consolidated domestic soft drink bottling operations contributed to joint ventures in early 1988. Results of acquisitions have been included from their respective dates of purchase. (See Notes to Consolidated Financial Statements on pages 43 and 44.)

(a) PepsiCo adopted the Financial Accounting Standard No. 87 (SFAS 87) on Employers' Accounting for Pensions. Prior years are not restated for SFAS 87. (See Note to Consolidated Financial Statements on page 47.)

(b) PepsiCo adopted the Financial Accounting Standard No. 52 (SFAS 52) on Foreign Currency Translation. Prior years are not restated for SFAS 52.

(c) In 1984 a $156.0 charge was recorded related to the planned sale of several company-owned foreign bottling operations ($62.0 after-tax or $0.22 per share). In 1985 a $25.9 credit was recorded as an adjustment to the charge ($14.9 after-tax or $0.05 per share).

(d) Included a $79.4 charge related to a reduction in net assets of certain foreign bottling operations ($79.4 after-tax or $0.28 per share).

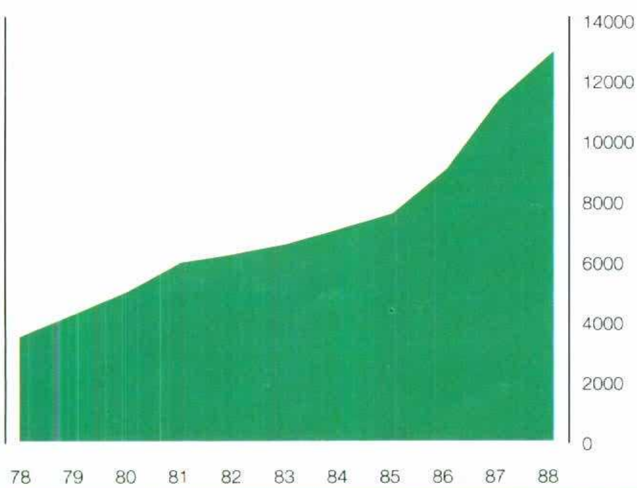
(e) Long-term debt includes the nonrecourse obligation. (See Note to Consolidated Financial Statements on page 45.)

(f) The return on average shareholders' equity and return on net sales are calculated using income from continuing operations.

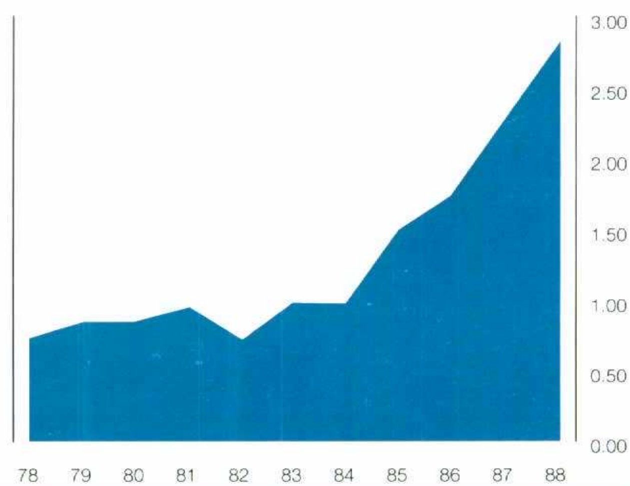
(g) Total debt includes notes payable and long-term debt (including current maturities); total capital employed includes total debt, other liabilities and deferred credits, deferred income taxes and shareholders' equity.

1986	1985	1984	1983	1982(b)	1981	1980	1979	1978
$9,017.1	$7,584.5	$7,058.6	$6,568.6	$6,232.4	$5,873.3	$4,955.9	$4,198.9	$3,523.7
8,187.9	6,802.4(c)	6,479.3(c)	5,995.7	5,684.7(d)	5,278.8	4,435.7	3,734.7	3,104.6
261.4	195.2	204.9	175.0	163.5	147.7	112.7	71.2	50.1
(122.7)	(96.4)	(86.1)	(53.6)	(49.1)	(35.8)	(27.1)	(21.9)	(19.3)
8,326.6	6,901.2	6,598.1	6,117.1	5,799.1	5,390.7	4,521.3	3,784.0	3,135.4
690.5	683.3	460.5	451.5	433.3	482.6	434.6	414.9	388.3
226.7	256.7	180.5	169.5	229.7	213.7	200.3	176.3	179.8
$ 463.8	$ 426.6	$ 280.0	$ 282.0	$ 203.6	$ 268.9	$ 234.3	$ 238.6	$ 208.5
$ 457.8	$ 543.7	$ 212.5	$ 284.1	$ 224.3	$ 297.5	$ 260.7	$ 250.4	$ 223.2
$ 1.77	$ 1.53(c)	$ 0.99(c)	$ 1.00	$ 0.73(d)	$ 0.97	$ 0.86	$ 0.86	$ 0.75
$ 1.75	$ 1.94	$ 0.75	$ 1.00	$ 0.80	$ 1.07	$ 0.95	$ 0.90	$ 0.80
262.2	280.7	287.5	286.4	284.7	279.2	273.5	278.4	278.6
$ 162.6	$ 161.2	$ 156.2	$ 151.4	$ 147.1	$ 129.9	$ 114.9	$ 102.4	$ 88.4
$ 0.628	$ 0.585	$ 0.555	$ 0.540	$ 0.527	$ 0.473	$ 0.420	$ 0.368	$ 0.325
$8,027.1	$5,889.3	$4,876.9	$4,446.3	$4,052.2	$3,960.2	$3,309.7	$2,800.0	$2,293.4
$2,632.6	$1,162.0	$ 668.1	$ 797.8	$ 843.2	$ 804.6	$ 769.5	$ 601.2	$ 459.9
$2,059.1	$1,837.7	$1,853.4	$1,794.2	$1,650.5	$1,556.3	$1,509.7	$1,387.2	$1,336.7
$ 7.91	$ 6.98	$ 6.58	$ 6.39	$ 5.89	$ 5.66	$ 5.51	$ 5.08	$ 4.79
$ 26¼	$ 23¾	$ 14	$ 12¾	$ 11⅓	$ 12⅛	$ 8⅔	$ 8⅓	$ 8½
260.3	263.1	281.7	280.7	280.1	274.8	273.8	272.9	279.2
214,000	150,000	150,000	154,000	133,000	120,000	111,000	105,000	95,000
87,000	72,000	62,000	60,000	48,000	49,000	51,000	53,000	55,000
23.8%	23.1%	15.4%	16.4%	12.7%	17.5%	16.2%	17.5%	16.7%
5.1%	5.6%	3.9%	4.3%	3.3%	4.6%	4.7%	5.7%	5.9%
47.5%	34.4%	26.5%	31.6%	34.6%	40.7%	34.9%	31.3%	26.3%

Net Sales
($ In Millions)



Income Per Share From Continuing Operations
(In Dollars)



Quarterly Financial Data

(in millions except per share amounts, unaudited)

	First Quarter 1988	First Quarter 1987	Second Quarter 1988	Second Quarter 1987	Third Quarter 1988	Third Quarter 1987	Fourth Quarter 1988	Fourth Quarter 1987	Full Year 1988	Full Year 1987
Net sales	**$2,568.3**	2,265.0	**3,010.2**	2,757.2	**3,240.2**	2,904.1	**4,188.3**	3,439.5	**13,007.0**	11,365.8
Gross profit[f]	**$1,344.1**	1,177.0	**1,589.6**	1,481.4	**1,688.0**	1,530.5	**2,129.5**	1,811.2	**6,751.2**	6,000.1
Income from continuing operations before income taxes	**$ 171.7[a]**	131.2	**325.2**	299.6[b]	**360.5[c]**	301.4[d]	**280.2**	223.3	**1,137.6**	955.5
Provision for income taxes	**$ 58.4**	49.5	**105.6**	110.6	**118.9**	111.5	**92.5**	78.8	**375.4**	350.4
Income from continuing operations	**$ 113.3**	81.7	**219.6**	189.0	**241.6**	189.9	**187.7**	144.5	**762.2**	605.1
(Loss) income from discontinued operations	**$ –**	(12.8)	**–**	–	**–**	–	**–**	2.5	**–**	(10.3)[e]
Net income	**$ 113.3**	68.9	**219.6**	189.0	**241.6**	189.9	**187.7**	147.0	**762.2**	594.8
Income (loss) per share:										
Continuing operations	**$ 0.43[a]**	0.31	**0.84**	0.72[b]	**0.91[c]**	0.72[d]	**0.72**	0.55	**2.90**	2.30
Discontinued operations	**$ –**	(0.05)	**–**	–	**–**	–	**–**	0.01	**–**	(0.04)[e]
Net income per share	**$ 0.43**	0.26	**0.84**	0.72	**0.91**	0.72	**0.72**	0.56	**2.90**	2.26

The first, second and third quarters of 1988 and 1987 each consisted of twelve weeks. The fourth quarter of 1988 and 1987 consisted of 17 and 16 weeks, respectively. Full years 1988 and 1987 consisted of 53 and 52 weeks, respectively.

The 1987 amounts have been reclassified to report under the equity method of accounting certain previously consolidated domestic soft drink bottling operations contributed to joint ventures in early 1988. (See Note to Consolidated Financial Statements on page 43.)

(a) Included a $14.5 charge ($10.4 after-tax or $0.04 per share) related to the reorganization of domestic soft drink operations.

(b) Included $27.8 in gains ($18.5 after-tax or $0.07 per share) resulting from the sale of a soft drink bottling operation in Puerto Rico, a Frito-Lay cookie production facility and several pizza restaurants in Australia.

(c) Included a $9.4 loss ($5.9 after-tax or $0.02 per share) resulting from the sale of a winery in Spain.

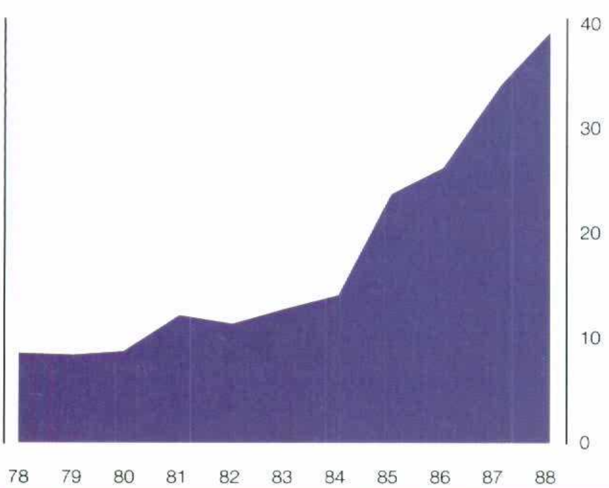
(d) Included a $8.0 charge ($4.8 after-tax or $0.02 per share) related to the reorganization of Kentucky Fried Chicken's domestic operations.

(e) Included a $9.0 after-tax loss ($0.03 per share) from the sale of La Petite Boulangerie, a retail bakery operation.

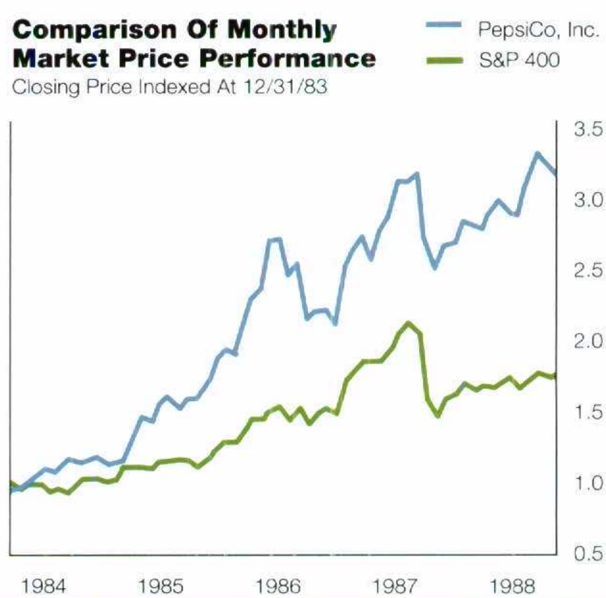
(f) The gross profit amounts reflect the reclassification of certain restaurant operating expenses from "Selling, administrative and other expenses" to "Cost of sales" in the Consolidated Statement of Income as follows (see Note to Consolidated Financial Statements on page 43):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
1988	**$232.4**	**$262.1**	**$273.5**	**$391.3**	**$1,159.3**
1987	$192.1	$222.6	$242.1	$323.7	$ 980.5

Year-End Market Price Of Stock
(In Dollars)



Comparison Of Monthly Market Price Performance
Closing Price Indexed At 12/31/83



Capital Stock Information

Stock Trading Symbol

PEP

Stock Exchange Listings

New York, Midwest, Basel,
Geneva, Zurich, Amsterdam, Tokyo

At year-end 1988 there were 94,000 shareholders of record.

Dividend Policy

Cash dividends are declared quarterly. On January 1, 1989, PepsiCo's quarterly dividend was $0.21 per share. We have paid quarterly cash dividends since PepsiCo was formed in 1965, and dividends have increased for 17 consecutive years.

The 1988 dividend payout ratio was 35% of 1987 earnings.

Dividends Paid Per Share

Quarter	1988	1987
1	**17¢**	16¢
2	**21¢**	17¢
3	**21¢**	17¢
4	**21¢**	17¢

Dividend Reinvestment Plan

Shareholders may increase their investment in our stock by enrolling in PepsiCo's Dividend Reinvestment Plan. PepsiCo pays all fees associated with the plan. A brochure explaining this convenient plan is available from our transfer agent:

Manufacturers Hanover Trust Company
450 West 33rd Street
New York, New York 10001

Stock Prices

The high, low and closing prices on the New York Stock Exchange, as reported by The Wall Street Journal, for each quarter of 1988 and 1987 were as follows (in dollars):

1988	High	Low	Close
Fourth Quarter	**43⅝**	**29⅞**	**39½**
Third Quarter	**38**	**33½**	**36½**
Second Quarter	**37¾**	**32¾**	**37**
First Quarter	**35⅞**	**30**	**35**
1987			
Fourth Quarter	40⅝	25½	33⅞
Third Quarter	42¼	35⅜	38
Second Quarter	37	29¾	36½
First Quarter	35¾	26	35

Stock Performance

As the chart on page 52 illustrates, the return on PepsiCo Capital Stock compares favorably with the performance of the Standard & Poor's 400 over the past five years.

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A $1,000 investment in our stock made in 1965 was worth approximately $19,000 on December 31, 1988, assuming the reinvestment of dividends. Past performance is not necessarily indicative of future returns on investments in PepsiCo Capital Stock.

Shareholder Information

Financial Information

Security analysts and representatives of financial institutions are invited to contact:

Margaret D. Moore
Vice President, Investor Relations
Telephone: (914) 253-3035

Shareholder Inquiries

Questions concerning your dividend reinvestment account, dividend payments or address changes should be addressed to:

Manufacturers Hanover Trust Company
Security Holder Relations
P.O. Box 24935, Church Street Station
New York, New York 10249
Telephone: (212) 613-7147

Please mention PepsiCo, your name as printed on your stock certificate, your social security number and include your address and telephone number in all correspondence.

Shareholders' Meeting

The Annual Meeting of Shareholders will be held at PepsiCo World Headquarters on Anderson Hill Road, Purchase, New York, at 10 a.m. (EDT), Wednesday, May 3, 1989. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

If you need additional assistance or information, or would like to receive free of charge a copy of PepsiCo's Form 10-K and 10-Q reports filed with the Securities and Exchange Commission, contact:

Manager of Shareholder Relations
PepsiCo, Inc.
Purchase, New York 10577
Telephone: (914) 253-3055

PepsiCo Directors

D. Wayne Calloway
Chairman of the Board
and Chief Executive Officer
PepsiCo, Inc., 53
Elected 1983
Committee: Executive

Roger B. Smith
Chairman and Chief Executive
Officer, General Motors, 63
Elected 1989
Committees: Audit,
Compensation

Roger A. Enrico
President and Chief Executive
Officer, PepsiCo Worldwide
Beverages, 44
Elected 1987
Committee: Executive

John J. Murphy
Chairman, Chief Executive
Officer and President, Dresser
Industries, 57
Elected 1984
Committees: Audit,
Compensation

Sharon Percy Rockefeller
Chairman, WETA Channel 26
Member, Board of Directors
Corporation for Public
Broadcasting, 44
Elected 1986
Committees: Audit,
Compensation

Frank T. Cary
Retired Chairman and Chief
Executive Officer,
International Business
Machines Corporation, 68
Elected 1983
Committees: Audit,
Compensation, Executive

Donald M. Kendall
Chairman of the Executive
Committee (Retired Chairman of the
Board and Chief Executive Officer)
PepsiCo, Inc., 68
Elected 1961

Andrall E. Pearson
Professor, Harvard Business School (Retired President and Chief Operating Officer, PepsiCo, Inc.), 63
Elected 1970

Robert H. Stewart, III
Vice Chairman of the Board
La Salle Energy Corporation, 63
Elected 1965
Committees: Audit, Executive, Compensation (chairman)

Michael H. Jordan
President and Chief Executive Officer, PepsiCo Worldwide Foods, 52
Elected 1985
Committee: Executive

Arnold R. Weber
President, Northwestern University, 59
Elected 1978
Committees: Audit, Compensation

Clifton C. Garvin, Jr.
Retired Chairman of the Board and Chief Executive Officer, Exxon Corporation, 67
Elected 1975
Committees: Compensation, Executive, Audit (chairman)

Robert S. Strauss
Partner: Akin, Gump, Strauss, Hauer & Feld, 70
Elected 1983
Committees: Audit, Compensation

William T. Coleman, Jr.
Senior Partner, O'Melveny & Myers, 68
Elected 1977
Committees: Audit, Compensation

Principal Divisions and Corporate Officers

Soft Drinks

PepsiCo Worldwide Beverages
Pepsi-Cola International
Somers, New York 10589
Roger A. Enrico, President

Pepsi-Cola Company
Somers, New York 10589
Craig E. Weatherup, President

Pepsi-Cola East
Somers, New York 10589
John M. Cranor, III, President

Pepsi-Cola South
12377 Merit Drive (Suite 1500)
Dallas, Texas 75251
Ronald W. Tidmore, President

Pepsi-Cola Central
300 Park Boulevard (Suite 500)
Itasca, Illinois 60143
Christopher A. Sinclair, President

Pepsi-Cola West
2600 Michelson (Suite 1700)
Irvine, California 92715
Christopher Hallenbeck, President

PepsiCo Wines and Spirits International
Purchase, New York 10577
John G. Swanhaus, Senior Vice President and General Manager

Snack Foods

PepsiCo Worldwide Foods
7701 Legacy Drive
Plano, Texas 75024
Michael H. Jordan, President

Frito-Lay, Inc.
7701 Legacy Drive
Plano, Texas 75024
Robert H. Beeby, President

PepsiCo Foods International
400 Frito-Lay Tower
Dallas, Texas 75235
John S. Pingel, Jr., President

Restaurants

Kentucky Fried Chicken Corporation
1441 Gardiner Lane
Louisville, Kentucky 40213
Richard P. Mayer, Chairman

KFC–USA
1441 Gardiner Lane
Louisville, Kentucky 40213
Steven V. Fellingham, President

KFC International
1441 Gardiner Lane
Louisville, Kentucky 40213
Donald L. Pierce, President

Pizza Hut, Inc.
9111 East Douglas
Wichita, Kansas 67207
Steven S Reinemund, President

Taco Bell Corp.
17901 Von Karman
Irvine, California 92714
John E. Martin, President

PepsiCo Food Service International
Purchase, New York 10577
Graham G. Butler, President

Executive Offices

Purchase, New York 10577
(914) 253-2000

Executive Officers

D. Wayne Calloway
Chairman of the Board and Chief Executive Officer

Donald M. Kendall
Chairman of the Executive Committee

Roger A. Enrico
President and Chief Executive Officer
PepsiCo Worldwide Beverages

Michael H. Jordan
President and Chief Executive Officer
PepsiCo Worldwide Foods

Robert G. Dettmer
Executive Vice President and Chief Financial Officer

Randall C. Barnes
Senior Vice President, Strategic Planning and New Business Development

Robert L. Carleton
Senior Vice President and Controller

Donovan R. Christopherson
Senior Vice President, Restaurant Development

J. Roger King
Senior Vice President, Personnel

Edward V. Lahey, Jr.
Senior Vice President, General Counsel and Secretary

Joseph F. McCann
Senior Vice President, Public Affairs

Leonard Schutzman
Senior Vice President and Treasurer

Vice Presidents

Robert O. Barber
Assistant Controller

Gerard W. Casey
Assistant General Counsel

Douglas M. Cram
Corporate Division Counsel

Allan B. Deering
Management Information Services

Lawrence F. Dickie
Associate General Counsel and Assistant Secretary

Robert S. Enright
Taxes

John J. Flaherty
General Auditor

James M. Griffith
Public Relations

Donald T. Haman
Tax Administration

Joseph J. Joyce
Assistant General Counsel

Margaret D. Moore
Investor Relations

Claudia E. Morf
Assistant Treasurer

Dan R. Paxton
Human Resources

Charles W. Rogers
Compensation and Benefits

David L. Wright
Government Affairs

Assistant Officers

Janet M. Lavine
Assistant Treasurer

Lawrence H. Meyer
Assistant Treasurer

Design: Eisenman & Enock, Inc.
Printing: National Bickford Foremost
Major Photography: Stephen Wilkes
Chairman's and Directors' Photography: Alen MacWeeney

Stretching Our International Presence

In 1988 our international sales grew nearly $500 million, and profits rose $40 million. In just the past two years, our international sales have doubled and profits nearly tripled. Here are some highlights.

Soft Drinks

- Landmark joint venture agreement will make Pepsi-Cola the first major foreign soft drink available in India in more than a decade.
- Renewed accord with U.S.S.R. extends PepsiCo trade relationship through the year 2000 and will double Pepsi-Cola business there.
- New 15-year agreement in China, the world's most populous country, will expand Pepsi-Cola operations with new concentrate and bottling plants.

Snack Foods

- Frito-Lay joint venture with Hostess creates #1 snack food company in Canada, expanding distribution opportunities and broadening product line.
- Italy, Turkey and India become our newest markets and promise to be as successful as last year's ventures in Greece, Portugal and Korea.
- Introduction of Frito-Lay style brands on a country-by-country basis grows sales and creates momentum for increased levels of consumption. Several more international product introductions are being planned.

Restaurants

- Openings in five more countries expand Pizza Hut restaurants to 50 markets. Plans to build Pizza Hut restaurants in several more countries, including the U.S.S.R., are underway.
- Topping off 1988, when we added nearly one new international restaurant per day, the 1,000th international Pizza Hut opens in Canada in early 1989.
- KFC's success with the world's largest quick service restaurant in China leads to further expansion in that huge market. In Japan, another key Pacific market, KFC approaches 800 units.

PEPSICO INC

PEPSI

Frito Lay®

Pizza Hut®

TACO BELL®

Kentucky Fried Chicken.

PepsiCo, Inc. Purchase, New York 10577